

No. 10324

United States //
Circuit Court of Appeals
For the Ninth Circuit.

UNITED STATES OF AMERICA,
Appellant,

vs.

CHINOOK INVESTMENT COMPANY, a cor-
poration,
Appellee.

Transcript of Record

Upon Appeal from the District Court of the United States
for the District of Oregon

FILED

JAN 9 - 1943

PAUL P. O'BRIEN,
CLERK

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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NAMES AND ADDRESSES OF ATTORNEYS
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United States Attorney

JAMES H. HAZLETT,

Assistant United States Attorney, and

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Special Assistant to the United States At-
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506 U. S. Court House,

Portland, Oregon.

For Appellee:

ROBT. T. JACOB,

917 Public Service Building, and

S. J. BISCHOFF,

Public Service Building,

Portland, Oregon.

In the District Court of the United States
for the District of Oregon
July Term, 1941

Be It Remembered, That on the 18th day of September, 1941, there was duly filed in the District Court of the United States for the District of Oregon, a Complaint in words and figures as follows, to wit: [1*]

In the District Court of the United States
for the District of Oregon
No. Civil 854

CHINOOK INVESTMENT COMPANY,
Plaintiff,

vs.

UNITED STATES OF AMERICA,
Defendant.

COMPLAINT

Comes now the Plaintiff and for its first cause of action against the defendant alleges as follows:

I.

That at all times mentioned herein, the Plaintiff, Chinook Investment Company, was a corporation organized and existing under and by virtue of the laws of the State of Oregon, with its principal office in the City of Portland, in the County of Multnomah, in the said State.

*Page numbering appearing at foot of page of original certified Transcript of Record.

II.

That Defendant, United States of America, is a sovereign State, free and independent.

III.

On or before March 15, 1937, Plaintiff executed and filed with the Collector of Internal Revenue, for the District of Oregon, an income tax return for the year 1936, and paid the tax of \$4,071.89 thereon, erroneously shown due in four equal installments, on March 15, June 15, September 15 and December 15, 1937.

IV.

That subsequently thereto, on or about June 29, 1939, Plaintiff filed claim for refund of the said sum with interest, which claim was disallowed on September 20, 1939, by the Internal Revenue Commissioner.

V.

That Plaintiff's gross income for the taxable year 1936 was as follows:

Rents	\$11,728.21
Dividends	27,145.09
	[2]
Loss on sale of stock and bonds.....	43,535.02
Gross Income Loss for Year.....	\$ 4,661.72

VI.

That plaintiff's allowable deductions for the taxable year aggregated \$14,331.45, making a total net loss of \$19,493.17.

VII.

That plaintiff's surplus was reduced in the said taxable year from \$252,644.95 to \$225,709.31 as a result of its operations, a reduction of \$26,935.64.

VIII.

That the Commissioner of Internal Revenue erroneously took into account only \$2,000.00 of the losses incurred by plaintiff from the sale of bonds in the taxable year 1936, and erroneously computed an undistributed profits tax of \$4,071.89, and erroneously assessed the same against plaintiff, although plaintiff had no profits in said taxable year, distributed or otherwise, but, on the contrary, suffered a loss as set forth above.

IX.

That losses on sales of stocks and bonds are deductible in determining net income of the plaintiff, in that Section 117 of the Revenue Act, fixing a limitation of \$2,000.00, is inapplicable to a corporation or this plaintiff, and is not a limitation on Section 14 of the Revenue Act of 1936, imposing surtax on undistributed profits.

X.

That the provisions of Section 14 of the Revenue Act of 1936 violate the Fifth Amendment to the Constitution of the United States in that it sets up an arbitrary basis of incidence as applied to the plaintiff by taxing as undistributed net income an amount which is actually nonexistent as income of any character whatever.

XI.

That the provisions of Section 14 of the Revenue Act of 1936 violate Article 9 of the Constitution of the United States in that they impose a tax, not on the [3] receipt of net income, but on its nondisposition, thus constituting a direct tax, without apportionment, on the unspent portion of corporate money.

XII.

That the provisions of Section 14 of the Revenue Act of 1936 violate the Tenth Amendment to the Constitution of the United States in that they attempt to regulate the internal affairs of corporations created by the States and constitute the exercise of powers not delegated to Congress.

(II.) .

And plaintiff, for its second cause of action against the defendant, alleges as follows:

XIII.

Plaintiff realleges the matters and things in Paragraphs I and II above set out and incorporates the same by reference in this its second cause of action.

XIV.

That on or before March 15, 1938, plaintiff executed and filed with the Collector of Internal Revenue for the District of Oregon an income tax return for the year 1937 and paid the tax of \$363.62 erroneously shown due thereon.

XV.

That the Commissioner of Internal Revenue thereafter assessed a deficiency in the sum of \$4,908.06 for the said taxable year against plaintiff, and plaintiff on or about December 2, 1939, paid the same together with interest thereon in the sum of \$508.36, a total of \$5,416.42.

XVI.

That subsequently thereto on or about March 15, 1940, plaintiff filed claim for refund of the sum of \$5,271.68 of the said sum, plus interest, and the said claim was disallowed on or about April 1, 1941, by the Collector of Internal Revenue.

XVII.

That plaintiff's gross income for the taxable year 1937 was as follows:

Interest	\$ 180.00
Rents	18,418.91
	[4]
Dividends	25,188.70
Loss on sale of bonds.....	(20,652.79)
	<hr/>
Gross Income	\$23,134.82

XVIII.

That plaintiff's surplus was reduced in the said taxable year 1937 aggregated \$22,041.33 and plaintiff was entitled to a dividends-received credit of \$21,557.01.

XIX.

That plaintiff's surplus was reduced in the said taxable year from \$225,709.31 to \$208,899.19, a reduction of \$16,810.12, as a result of its operations.

XX.

That the Commissioner of Internal Revenue erroneously took into account only \$2,000.00 of the losses incurred by Plaintiff from the sale of bonds in the taxable year 1937, and erroneously computed an Undistributed Profits tax of \$1,086.60, and erroneously assessed the same against plaintiff, although plaintiff had no profits subject to taxation in the said taxable year, distributed or otherwise.

XXI.

That the Commissioner of Internal Revenue erroneously took into account only \$2,000.00 of the losses incurred by plaintiff from the sale of bonds in the taxable year 1937 and erroneously computed a personal holding company tax, and erroneously assessed the same against plaintiff, although plaintiff had no taxable income in the said taxable year and was not a personal holding company for the reason that rents constituted more than 50 per cent of its gross income.

XXII.

That plaintiff realleges the matters and things in Paragraphs IX, X, XI and XII of this its complaint, and incorporates the same by reference in this, its second cause of action.

XXIII.

That no part of the aforesaid taxes for the taxable years 1936 and 1937, or the interest thereon, has been refunded to plaintiff, but the said taxes and interest are wrongfully withheld from plaintiff. [5]

XXIV.

That the amount involved in this controversy does not exceed the sum or value of \$10,000.00.

Wherefore, plaintiff prays judgment against the defendant for the sum of \$9,343.57, together with interest thereon at the rate of 6 per cent per annum from the dates of payment, for plaintiff's costs and disbursements herein, and for such other or further relief as is just and equitable to be awarded to plaintiff in this proceeding.

ROBT. T. JACOB,

Attorney for Plaintiff

917 Public Service Building

Portland, Oregon

ATwater 9401

State of Oregon,

County of Multnomah—ss.

I, Robert S. Farrell, being first duly sworn, depose and say that I am the President of the Chinook Investment Company, plaintiff in the above entitled cause; and that the foregoing complaint is true as I verily believe.

ROBERT S. FARRELL

Subscribed and sworn to before me this 18th day of September, 1941.

[Seal]

RENEE FRITSCH

Notary Public for Oregon.

My Commission expires 2/5/45.

[Endorsed]: Filed September 18, 1941. [6]

And Afterwards, to wit, on the 29th day of December, 1941, there was duly Filed in said Court, an Answer, in words and figures as follows, to wit: [7]

[Title of District Court and Cause.]

ANSWER

Comes Now the defendant by Carl C. Donough, United States Attorney, and C. Laird McKenna, Assistant United States Attorney for the District of Oregon, its attorneys, and in answer to plaintiff's complaint filed in the above-entitled action, admits, denies and alleges as follows:

I.

Admits the allegations of paragraphs I, II, IV, XV and XXIV of the complaint.

II.

Admits the allegations of paragraph III of the complaint except the dates therein. Admits, however, that plaintiff's 1936 return was filed on March 1, 1937, and that the installments of tax alleged were paid on March 18, June 12, September 14, and December 3, 1937, respectively.

III.

Denies the allegations of paragraph V of the complaint. Admits, however, that plaintiff reported on its 1936 Corporation Income and Excess Profits Tax Return (Form 1120) income from rents of \$11,725.21 and from dividends of \$27,145.09 as alleged, and that it reported a capital net [8] loss of \$38,-

487.49, alleged to have been sustained on the sale of Chinook Investment Company stocks and bonds, of which amount it deducted \$2,000, pursuant to the provisions of Section 117 (d) of the Revenue Act of 1936.

IV.

Denies the allegations of paragraph VI of the complaint. Admits, however, that plaintiffs reported and claimed total deductions of \$14,331.45 claimed for the year 1936.

V.

Denies the allegations of paragraph VII of the complaint. Admits, however, that plaintiffs reported a surplus of \$232,644.95 for the year 1936.

VI.

Denies the allegations of paragraphs VIII, IX, X, XI, and XII of the complaint.

VII.

Since paragraph XIII of the complaint realleges all matters and things in paragraphs I and II of the said complaint and incorporates the same in the complaint by way of its second cause of action in this proceeding, defendant admits the allegations thus incorporated therein similarly as paragraphs I and II thereof are admitted as above indicated.

VIII.

Admits the allegations of paragraph XIV of the complaint except that it is denied that the amount shown due thereon was erroneously paid as alleged.

IX.

Denies the allegations of paragraph XVI of the complaint. Admits, however, that plaintiffs filed refund [9] claims for the year 1937, which were rejected as follows:

Date Filed	Date Rejected
February 27, 1939	March 16, 1940
June 30, 1939	March 16, 1940
September 24, 1940	April 1, 1941

X.

Denies the allegations of paragraph XVII of the complaint. Admits, however, that plaintiffs reported for the year 1937 income of \$180 from interest, \$18,418.91 from rent, \$25,188.70 from dividends, and capital net loss of \$20,652.79, of which it deducted \$2,000, pursuant to the provisions of Section 117 (d) of the Revenue Act of 1936.

XI.

Denies the allegations of paragraphs XVIII, XIX, XX, XXI and XXII of the complaint.

XII.

Admits the allegations of paragraph XXIII of the complaint, except that it is denied that the taxes and interest are wrongfully withheld as alleged.

XIII.

Denies the concluding paragraph of the complaint and that plaintiffs are entitled to the relief prayed for.

Wherefore, it is prayed that the complaint be dismissed with costs to plaintiffs.

CARL C. DONAUGH

United States Attorney.

C. LAIRD McKENNA

Assistant United States
Attorney

Address: 506 U. S. Court
House, Portland, Oregon.

[Endorsed]: Filed December 29, 1941. [10]

And Afterwards, to wit, on Tuesday, the 17th day of February, 1942, the same being the 90th Judicial day of the Regular November, 1941, Term of said Court; present the Honorable Claude McColloch, United States District Judge, presiding, the following proceedings were had in said cause, to wit: [11]

[Title of District Court and Cause.]

PRETRIAL ORDER

This cause having duly come on for pretrial before the undersigned Judge of the above entitled Court on the 17th day of February, 1942, the plaintiff appeared herein in person and by Robert T. Jacob and S. J. Bischoff, his attorneys; defendant appeared herein by Thomas R. Winter, its attorney; whereupon plaintiff moved the Court for leave to amend the Complaint by interlineation in the following respects, to-wit: By inserting in Line 2 of

Paragraph XX between the word "of" and "bonds" the words "stocks and". In Paragraph XX line 3 the figure "\$1086.60" should be changed to read "\$4908.06". In Paragraph XI the words "Article 9 of" to be changed to read "Sixteenth Amendment to".

No objection was interposed to said motion, and it is

Ordered that the motion be and the same hereby is granted; leave is hereby granted to make the said changes by interlineation, and it is further

Ordered that said allegations be deemed denied.

Thereafter counsel for both sides made their statements as to the character of the issues of law and fact involved and the issues were stated to be as follows:

Defendant asserts and contends that there is no issue of fact involved in the case; that the figures set forth in the income tax [12] returns for the years 1936 and 1937 are correct and have not been challenged; and that there is only one issue of law involved in both causes of action, to-wit: that plaintiff was not entitled to deduct the whole of the losses sustained in the years 1936 and 1937 resulting from the sale of securities in those years, because the securities were capital assets and deduction is limited to \$2,000 under Section 117(d) of the Revenue Act of 1936.

Plaintiff contends that the securities sold in the years 1936 and 1937 were not "capital assets" but that plaintiff bought and sold stocks in the ordi-

nary course of business as a regular trade and business, and that the limitation of Section 117(d) does not apply; that it was entitled to deduct the full amount of loss sustained in both years in determining the existence of undistributed profits or income in those years; that even though the securities be deemed "capital assets" that it was entitled nevertheless to deduct the total loss because the term "undistributed profits" must be used in the sense of earnings or profits as the term is used in Section 115 of the Internal Revenue Act defining dividends; that in determining the existence of net profits there must also be deducted the dividends received credit under Section 26(b) of the Internal Revenue Act; that it was not a personal holding company in the year 1937 because the rent exceeded 50% of gross income in that year; and if the undistributed profits tax act and the personal holding company tax act are not construed and applied so as to permit the deduction of the entire loss sustained, the acts are unconstitutional because they do not provide for tax on the receipt of income, but provide a penalty for failure to distribute income even though there be no undistributed profits in fact, and on the further ground that the acts as so construed and applied are grossly arbitrary and unreasonable.

It is therefore,

Ordered that the issues of law and fact for determination be deemed settled as aforesaid. [13]

Thereafter plaintiff and defendant introduced in evidence the following exhibits and no objections

were interposed except where objection is specifically noted herein:

Plaintiff's Exhibit 1:

Certified copy of Income Tax Return of plaintiff for year 1936.

Plaintiff's Exhibit 2:

Certified copy of letter dated March 2nd, 1937, addressed to Chinook Investment Company.

Plaintiff's Exhibit 3:

Certified copy of claim for refund of \$4,071.89, received by Collector February 18, 1938.

Plaintiff's Exhibit 4:

Certified copy of Amended Claim for Refund of \$4,071.89, received by Collector June 30, 1939, with letter dated September 20, 1939, addressed to Chinook Investment Company, disallowing the claim.

Plaintiff's Exhibit 5:

Certified copy of Income Tax and Excess Profits Tax Return for 1937, filed by Chinook Investment Company.

Plaintiff's Exhibit 6:

Certified copy of Return on Personal Holding Company *from* for year 1937, of Chinook Investment Company.

Plaintiff's Exhibit 7:

Certified copy of Internal Revenue Agent's Report dated April 20, 1939.

(Mr. Winter: We want to object to this because it is irrelevant and immaterial, not the

best evidence; and further object to Exhibit 7 in that it appears there is a lot of pencil notations on it we know nothing about, and under-scorings and pencil notations and other marks.

Mr. Bischoff: In this respect we ask leave of Court to erase the lead pencil notations appearing thereon and they are not to be deemed a part of the document.)

Plaintiff's Exhibit 8:

Certified copy of Waiver of Restrictions on Assessment and Collection of Deficiency in Tax for 1937.

Plaintiff's Exhibit 9:

Certified copy of Claim for Refund of \$363.62, received by Collector February 27, 1939.

Plaintiff's Exhibit 10:

Certified copy of letter dated March 16, 1940, to Chinook Investment Company from Guy T. Helvering, Commissioner.

Plaintiff's Exhibit 11:

Certified copy of Amended Claim for Refund of \$363.62 with interest, received by Collector June 30, 1939.

Plaintiff's Exhibit 12:

Certified copy of Amended Claim for Refund of \$5,271.68, with copy of letter dated April 1st, 1941, to Chinook Investment Company from Guy T. Helvering, Commissioner. [14]

Plaintiff's Exhibit 13:

Certified copy of Articles of Incorporation of Chinook Investment Co.

(Mr. Winter: We will object to it as irrelevant and immaterial, not within any issue in this case; no allegation as to—nothing in the complaint or pleadings, or in the claim for refund, on which suit is based, as to the existence of the corporation, and there is no issue as to the business which the corporation was engaged in, it being our position that the intent to form a personal holding corporation is immaterial, because when the two conditions are present it is a personal holding corporation regardless of the intent of the incorporators.)

Plaintiff's Exhibit 14:

Bundle of invoices of purchases and sales of Stock by Plaintiff.

(Mr. Winter: We object to them, first, as not being properly identified; second, as being within no issues in this case, irrelevant and immaterial, the return for the year 1936, Pre-trial Exhibit 1, showing, under Schedule B, Capital Gains and Losses from sales or exchanges only, the date acquired—first, Description of Property; date acquired—when I said “description of Property”, I mean the description of the stocks and/or bonds; date sold; gross sales price or contract price; cost; and amount of gain or loss; and there is no issue in the pleadings with respect to the amounts

thereof, nor as to the reporting of them as capital losses, and no claims for refund filed or contention theretofore made, either in the claim for refund or complaint, that they were other than capital losses as so reported. Were there a number of years in addition to the years here in question?

Mr. Bischoff: For a series of years, preceding and succeeding the two years in question.

Mr. Winter: We further object on the grounds that they are not in any issue in this case, appear to be transactions preceding and succeeding the years here involved.)

Plaintiff's Exhibit 14-a:

Bundle of invoices of purchases and sales of stock for year 1936.

Plaintiff's Exhibit 14-b:

Bundle of invoices of purchases and sales of stock for the year 1937.

(Mr. Winter: The same objection, heretofore made to Exhibit 14 in toto—irrelevant, immaterial, not within the issues of this case. I want to further object to Pre-Trial Exhibits, particularly Exhibits 14-A and 14-B, on the grounds that they are not properly identified, and appear on their face to be sales invoices, purchases—sales invoices for purchase of shares of stock by the plaintiff corporation for the years involved, and do not disclose, nor controvert the item set forth as gain or loss on the sale—capital gain or losses from the sale or

exchange of stock set forth in the 1936 and 1937 income tax returns filed herein.) [15]

Defendant's Exhibit 15:

Certified copy of letter dated November 28, 1939, to Chinook Investment Company from J. W. Maloney, Collector, in re deficiency in income tax for 1937, amounting to \$722.98.

(Mr. Bischoff: Objected to as immaterial, irrelevant and incompetent, and that the amount referred to in this Exhibit is not in any way involved in this case.)

Defendant's Exhibit 16:

Certified copy of letter dated November 28, 1939 to Chinook Investment Company from J. W. Maloney, Collector, in re deficiency in income tax for 1937 amounting to \$4,185.08.

Dated as of the 17th day of February, 1942.

CLAUDE McCOLLOCH,
Judge.

Copy received 3/13/42.

[Endorsed]: Filed June 9, 1942. [16]

And Afterwards, to wit, on the 9th day of June, 1942, there was duly Filed in said Court, an Opinion, in words and figures as follows, to wit: [17]

[Title of District Court and Cause.]

MEMORANDUM OF DECISION

I feel that Section 117 (b) should be given a broader interpretation than counsel for defendant concedes, and, since Mr. Farrell's testimony is undisputed that he kept the securities account active by buying and selling, I must hold that the securities were not capital assets within the meaning of the statute and the pertinent regulations.

Even though it be felt that the claim for refund was not broad enough to raise the question whether the securities involved were capital assets, defendant's authorities do not support the proposition that such question cannot be raised in a subsequent suit for recovery.

Since there was full discussion at the pre-trial hearing of plaintiff's intention to rely on the point that the securities sold at a loss were not capital assets, the complaint may be amended to raise this question more specifically, if plaintiff's attorneys deem that such amendment is necessary.

Dated June 9, 1942.

CLAUDE McCOLLOCH,
Judge.

[Endorsed]: Filed June 9, 1942. [18]

And Afterwards, to wit, on the 16th day of June, 1942, there was duly Filed in said Court, and entered upon the record of said Court, Findings of Fact and Conclusions of Law, in words and figures as follows, to wit: [19]

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This cause having come on for trial before this Court sitting without a jury, the Plaintiff appeared herein in person and by Robt. T. Jacob and S. J. Bischoff, its attorneys; the Defendant appeared herein by Carl C. Donough and Thomas R. Winter, its attorneys; the pleadings and proofs of the parties were duly heard and considered, the cause was taken under advisement and the Court being now advised in the premises, does hereby make and file herein its

FINDINGS OF FACT

I.

That at all of the times herein mentioned, the Plaintiff, Chinook Investment Company, was a corporation organized and existing for profit, under and by virtue of the laws of the State of Oregon, with its principal office in the City of Portland, in the County of Multnomah, State of Oregon; that Plaintiff was during all of the times herein mentioned a citizen and resident of the State of Oregon; that its charter provisions contain the following:

“1. To own, buy, sell or to acquire by sale, trade or exchange, bonds, notes, mortgages and other evidences of indebtedness or shares of stock in other corporations, and to exercise while the owner thereof all the rights, powers and privileges, including the right to vote thereon, that a natural person being owner thereof might, could or would exercise, negotiate loans and transact any other business usually transacted by a credit or finance company.” [20]

II.

That Defendant, United States of America, is a sovereign State, free and independent.

III.

That the amount in controversy herein is in excess of the sum of \$3,000.00 but does not exceed the sum of \$10,000.00.

IV.

That on March 1st, 1937, Plaintiff executed and filed with the Collector of Internal Revenue for the District of Oregon, an Income Tax Return for the calendar year 1936, showing no taxable income; that thereafter, to-wit: on March 2, 1937, the Collector of Internal Revenue for said District, on his own Motion, made an assessment against the Plaintiff for said calendar year of \$4,071.89, “surtax on undistributed profits”; that Plaintiff paid the tax so assessed as follows:

Date Paid	Amount
March 18, 1937.....	\$1,018.00
June 12, 1937.....	1,018.00
Sept. 14, 1937.....	1,018.00
Dec. 3, 1937.....	1,017.89
Total.....	<hr/> \$4,071.89

V.

That on June 29, 1939, Plaintiff filed with the Collector of Internal Revenue for the District of Oregon a Claim for Refund of the sum paid as aforesaid, which Claim was disallowed by the Commissioner of Internal Revenue on September 20, 1939.

VI.

That on or before March 15, 1938, Plaintiff executed and filed with the Collector of Internal Revenue for the District of Oregon, an Income Tax Return for the calendar year 1937, which Return as executed and filed disclosed a tax liability of \$363.62 as undistributed profits surtax, which Plaintiff paid to the Collector of Internal Revenue at the time of filing said Return. [21]

VII.

That thereafter the Return of the Plaintiff for the calendar year 1937 was examined by an agent of the Internal Revenue Department and as a result thereof an additional assessment of \$5,271.68, together with interest, making a total assessment of \$5,417.42 was made by the Commissioner of Internal Revenue, representing a Personal Holding Company tax on undistributed profits, and said Commis-

sioner required Plaintiff to execute and file an Amended Personal Holding Company Return upon the figures computed by the said Revenue Agent. That Plaintiff protested the liability for the said additional assessment, but to avoid imposition of penalty, executed the said Amended Personal Holding Company Return and filed the same, accompanied by a letter which was attached thereto, in words and figures as follows:

“A return on Form 1120 was prepared and filed and failure to file the Form 1120P for Personal Holding Companies was due to the fact that it was the contention of the taxpayer that it was not a Holding Company and hence not required to file Form 1120P. The returns of the taxpayer had been examined for the year 1936 and the company declared not to be a Personal Holding Company, and the officers believed that the status of the Company had not changed as to the year 1937. The return herewith submitted is submitted at the request of the Internal Revenue Agent and the signing and submission thereof is made with the specific reservation that it is not an admission of affiant's liability as a Personal Holding Corporation, but is made for the purpose of avoiding litigation, if possible, and in the hope that an equitable determination of the taxpayer's status may be made without the necessity of legal action. The right to later contest the va-

lidity of the assessment as a personal holding company is specifically reserved.

CHINOOK INVESTMENT
COMPANY,

By ROBERT S. FARRELL,
President.

Subscribed and sworn to before me this 15
day of November, 1939.''

VIII.

That by reason of said Internal Revenue Agent's report and the assessment made thereon, Plaintiff paid the said sum of \$5,417.42, which together with the aforesaid sum of \$363.62 made a total of \$5,781.04 paid by Plaintiff at the following times:

[22]

Date Paid	Amount
March 9, 1938.....	\$ 90.91
June 13, 1938.....	90.91
Sept. 16, 1938.....	90.90
Dec. 15, 1938.....	90.90
Dec. 13, 1939	
Tax and Interest.....	5,417.42
Total	<u>\$5,781.04</u>

IX.

That on February 27, 1937, Plaintiff filed with the Collector of Internal Revenue for the District of Oregon its Claim for Refund in the sum of \$363.62, paid as aforesaid; that on June 30, 1939, Plaintiff filed with said Collector of Internal Revenue an Amended Claim for Refund of \$363.62 and on September 24, 1940, Plaintiff filed an Amended Claim for Refund for the additional sum of

\$5,271.68 with the said Collector of Internal Revenue.

That the Claim for Refund filed February 27, 1939, was rejected March 16, 1940; that the Amended Claim for Refund filed June 30, 1939, was rejected on March 16, 1940, and the Amended Claim for Refund filed September 24, 1940, was rejected April 1, 1941.

X.

That Plaintiff's gross receipts and deductions for the calendar year 1936 were as follows:

Gross Receipts	
Rents	\$11,728.21
Dividends	27,145.09
Total.....	38,873.30
Deductions	
Salaries	1,200.00
Repairs	82.01
Interest	3,200.00
Taxes	5,050.56
Depreciation	4,300.28
Insurance	67.41
Expenses	403.47
Total.....	14,331.45
Dividend received Credit (85% of \$27,145.09) ..	23,073.32
Loss from sale of Securities.....	40,035.02
Plaintiff's Surplus Account was reduced in 1936 by the sum of.....	\$26,935.64

[23]

XI.

That the Plaintiff's gross receipts and deductions for the calendar year 1937 were as follows:

Gross Receipts

Interest	\$ 180.00
Rent	18,418.91
Dividends	25,188.70
Total.....	43,787.61

Deductions

Repairs	1,774.72
Interest	8,726.37
Taxes	9,829.72
Depreciation	5,212.87
Expenses	1,134.33

Total.....	26,674.11
Dividends received Credit (85% of \$25,188.70)..	21,410.49
Loss from sale of Securities.....	20,652.79
Plaintiff's Surplus Account was reduced during the calendar year 1937 by the sum of.....	16,810.12

XII.

That during the calendar years 1936 and 1937 the Plaintiff corporation engaged in the business of buying and selling stocks and bonds to and from customers in the ordinary course of its trade or business, and maintained offices and facilities for carrying on said business.

That the stocks and bonds held by it during the said calendar years were held by it primarily for sale to customers in the ordinary course of its trade or business, and not for investment or speculation, and the securities bought and sold by Plaintiff during each of said calendar years resulting in the losses sustained, were held, dealt in and sold in the manner herein set forth.

XIII.

That during said period of time Plaintiff bought and sold stocks and bonds for its own account for

cash, and not on margin; that it bought and sold stocks and bonds at private sales; selling securities to individuals desiring [24] to buy the same and purchasing securities from individuals desiring to sell the same; that Plaintiff also purchased and sold securities in what are known as "over the counter" transactions, that is, purchases and sales outright to and from private dealers in securities, and also bought and sold some securities through brokers in the market. It bought and sold stocks and bonds in corporations in the management and affairs of which Plaintiff, by its President, took part.

XIV.

That the President of Plaintiff kept in very close touch with the market and kept Plaintiff's cash on hand and moneys that it had borrowed moving all the time in the business of buying and selling securities, purchasing from \$200,000.00 to \$300,000.00 worth per year, and selling a like amount in each year.

That the purchases and sales were made in varying quantities and amounts, ranging from a few shares at low prices to large blocks of stock at higher prices. Such purchases and sales were not made intermittently or occasionally, but were carried on as a regular business during each of said years.

XV.

That Plaintiff did not make any net profit during the calendar years 1936 and 1937, but, on the contrary, sustained net losses in both of the said calen-

dar years, and Plaintiff had no undistributed profits in either year.

XVI.

That the time of the pre-trial [25] proceedings held herein, the Plaintiff stated its position and contention that the said securities bought and sold as aforesaid were not capital assets; that the Defendant did not at said time claim any surprise by reason of said Plaintiff's contention and did not move for any continuance by reason thereof; that the pre-trial Order tendered by Defendant did not challenge the fact that the issue was before the Court; and the pretrial order signed stated this issue that thereafter the issue of fact as to whether the said securities bought and sold as aforesaid were capital assets was tried to the Court; that Defendant did not at any time during the trial of the action claim surprise by reason of Plaintiff's contention that the said securities were not capital assets; that Defendant did not in the Brief submitted to the Court claim surprise by Plaintiff's said contention; that Defendant first asserted the contention after Briefs were exchanged and the case was finally argued.

Upon the foregoing Findings of Fact, the Court now makes and files herein its

CONCLUSIONS OF LAW

I.

That this Action is properly brought under the Tucker Act, and the Court has jurisdiction of the subject matter and the parties.

II.

That the Securities sold by Plaintiff during the Calendar years 1936 and 1937 resulting in the losses as set forth in the Findings of Fact herein were not capital assets within the meaning of Section 117 of the Revenue Act of 1936 and the Regulations promulgated in connection therewith, and that Plaintiff is therefore entitled to deduct the whole amount of the losses sustained by reason of the sale of said securities in said years, and was not limited to a deduction of \$2,000.00 only in either of the said years. [26]

III.

That by reason of the deduction of the losses sustained as aforesaid in both of the said calendar years, Plaintiff had no undistributed profits which became subject to taxation under the Revenue Act of 1936 for the year 1936, or subject to taxation under the Personal Holding provisions of the Act in force during the year 1937.

IV.

That the assessments made by the Commissioner of Internal Revenue for the calendar years 1936 and 1937 were erroneous and the taxes paid by Plaintiff by reason of said assessments were erroneously paid and received by the Collector of Internal Revenue, and by reason thereof Plaintiff is entitled to recover from the Defendant the sum of \$4,071.89 on its first cause of action; and that Plain-

tiff is entitled to recover from the Defendant the sum of \$5,781.04 on its second cause of action.

V.

The Complaint may be deemed amended by interlining in the third line of Paragraph IX thereof after the word Plaintiff, the following:

“because the loss did not result from sales of capital assets.”

and by interlining in Paragraph XX thereof in the third line, after the figure 1937, the words:

“because the loss did not result from the sale of capital assets.” [27]

That Plaintiff is entitled to the entry of Judgment in its favor as herein set forth, together with its costs and disbursements incurred herein as taxed by the Clerk of the Court.

Exception to foregoing requested and allowed to defendant June 16, 1942.

CLAUDE McCOLLOCH

Judge

[Endorsed]: Filed June 18, 1942. [28]

And Afterwards, to wit, on Tuesday, the 16th day of June, 1942, the same being the 91st Judicial day of the Regular March, 1942, Term of said Court; present the Honorable Claude McCulloch, United States District Judge, presiding, the following proceedings were had in said cause, to wit: [29]

In the District Court of the United States
For the District of Oregon

Civil Action No. 854

CHINOOK INVESTMENT COMPANY,
Plaintiff,

vs.

UNITED STATES OF AMERICA,
Defendant.

JUDGMENT

This cause having come on for trial upon the issues formed by the pleadings filed herein, the Plaintiff appearing in person and by Robt. T. Jacob and S. J. Bischoff, its attorneys, the Defendant appearing herein by Carl C. Donough and Thomas R. Winter, its attorneys, the pleadings and proofs of the parties herein having been duly heard and considered, the cause was taken under advisement. Thereafter, the Court duly made and filed its Memorandum of Decision, Findings of Fact and Conclusions of Law.

Now on Motion of Robt T. Jacob and S. J. Bischoff, attorneys for Plaintiff, it is

Ordered, Adjudged and Decreed that Plaintiff, Chinook Investment Company, a corporation, do have judgment for and recover of and from the Defendant, United States of America, the sum of \$4,071.89 upon the first cause of action set forth in the Complaint, and the sum of \$5,781.04 upon the second cause of action set forth in the Complaint, together with Plaintiff's costs and disbursements

in the sum of \$65.50 as taxed by the Clerk of this Court.

Dated this 16th day of June, 1942.

(s) CLAUDE McCOLLOCH

Judge.

[Endorsed]: Filed June 16, 1942. [30]

And Afterwards, to wit, on the 14th day of September, 1942, there was duly Filed in said Court, a Notice of Appeal, in words and figures as follows, to wit: [31]

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice is hereby given that the United States of America, defendant above named, hereby appeals to the Circuit Court of Appeals for the Ninth Circuit from the final Judgment dated the 16th day of June, 1942, and filed in the above-entitled court on the 18th day of June, 1942.

Dated this 14th day of September, 1942.

CARL C. DONAUGH,

United States Attorney.

JAMES H. HAZLETT,

Assistant United States Attorney.

THOMAS R. WINTER,

Special Assistant to the
United States Attorney.

[Endorsed]: Filed September 14, 1942. [32]

And Afterwards, to wit, on the 19th day of September, 1942, there was duly Filed in said Court, Appellant's statement of points, in words and figures as follows, to wit: [33]

[Title of District Court and Cause.]

STATEMENT OF POINTS

The appellant, United States of America, will rely upon the following points in the prosecution of its appeal from the Judgment in the United States District Court for the District of Oregon:

I.

The District Court erred in entering Judgment for the appellee and against the appellant in the sum of \$4,071.89 upon the alleged first cause of action and the sum of \$5,781.07 upon the alleged second cause of action, together with costs and disbursements; conversely, the Court erred in failing and refusing to enter Judgment for the appellant dismissing appellee's alleged causes of action with costs.

II.

The District Court erred in making and entering Findings X and XI in so far as they purport to find that the appellee sustained an ordinary loss on the sale of its securities as distinguished from a capital loss; further, these Findings with respect to dividends received credit and surplus account were in-

competent, immaterial and irrelevant in determining the issues of whether the appellee was subject to surtax on undistributed profits for the year 1936 and subject to surtax as a personal holding company for the year 1937. [34]

III.

The District Court erred in making and entering Findings XII, XIII and XIV because the contents thereof were not supported by the evidence and are contrary to the evidence in so far as they purport to find that the appellee was “in the business of buying and selling stocks and bonds to and from customers in the ordinary course of its trade or business” or that it sustained an “ordinary loss” as distinguished from a “capital loss”; further, the contents thereof were incompetent, immaterial and irrelevant in determining the issues raised by the appellee’s claim for refund and complaint in this suit of whether the Commissioner erroneously refused them to permit the appellee to deduct the entire amount of its “capital loss” in arriving at the amount of net income for the years 1936 and 1937.

IV.

The District Court erred in admitting any testimony or exhibits on the question of whether the appellee sustained “capital losses” as alleged in appellee’s claim for refund and suit in this action as distinguished from “ordinary losses”.

V.

The District Court erred in making and entering Finding XV because the contents thereof were not supported by the evidence and are contrary to the evidence in this suit.

VI.

The District Court erred in overruling the appellant's objections and admitting in evidence the following Exhibits 14, 14-a and 14-b:

Plaintiff's Exhibit 14:

Bundle of invoices of purchases and sales of stock by plaintiff. [35]

“(Mr. Winter: We object to them, first, as not being properly identified; second, as being within no issues in this case, irrelevant and immaterial, the return for the year 1936, Pre-trial Exhibit 1, showing, under Schedule B, Capital Gains and Losses from sales or exchanges only, the date acquired—first, Description of Property; date acquired—when I said “Description of Property”, I mean the description of the stock and/or bonds; date sold, gross sales price or contract price; cost; the amount of gain or loss; and there is no issue in the pleadings with respect to the amounts thereof, nor as to the reporting of them as capital losses, and no claims for refund filed or contention theretofore made, either in the claim for refund or complaint, that they were other than capital losses as so reported. Were there a number of

years in addition to the years here in question?

“Mr. Bischoff: For a series of years, preceding and succeeding the two years in question.

“Mr. Winter: We further object on the grounds that they are not in any issue in this case, appear to be transactions preceding and succeeding the years here involved.)”

Plaintiff's Exhibit 14-a:

Bundle of invoices of purchases and sales of stock for year 1936.

Plaintiff's Exhibit 14-b:

Bundle of invoices of purchases and sales of stock for the year 1937.

“(Mr. Winter: The same objection heretofore made to Exhibit 14 in toto—irrelevant, immaterial, not within the issues of this case. I want to further object to Pre-Trial Exhibits, particularly Exhibits 14-a and 14-b, on the grounds that they are not properly identified, and appear on their face to be sales invoices, purchases—sales invoices for purchase of shares of stock by the plaintiff corporation for the years involved, and do not disclose, nor controvert the item set forth as gain or loss on the sale—capital gain or losses from the sale or exchanges of stock set forth in the 1936 and 1937 income tax returns filed herein.)”

VII.

The District Court erred in making and entering Finding XVI because the contents thereof were not supported by and are contrary to the evidence and record in this suit as shown in Paragraph V, *supra*. [36]

VIII.

The District Court erred in holding (Conclusion of Law II) "That the Securities sold by Plaintiff during the Calendar years 1936 and 1937 resulting in the losses as set forth in the Findings of Fact herein were not capital assets within the meaning of Section 117 of the Revenue Act of 1936 and the Regulations promulgated in connection therewith, and that Plaintiff is therefore entitled to deduct the whole amount of the losses sustained by reason of the sale of said securities in said years, and was not limited to a deduction of \$2,000.00 only in either of the said years."

IX.

The District Court erred in holding (Conclusion of Law III) that the appellee had no undistributed profits which became subject to taxation under Section 14 of the Revenue Act of 1936 for the year 1936 or subject to taxation under Section 351 of the Revenue Act of 1937.

X.

The District Court erred in holding (Conclusion of Law IV) that the assessments made by the Commissioner of Internal Revenue for the calendar

years 1936 and 1937 were erroneous and that under the law and the evidence appellee was entitled to Judgment against appellant.

XI.

The District Court erred in holding (Conclusion of Law V) that the appellee's complaint in this suit may be amended by interlineation thereby alleging a new and different cause of action and on a different ground other than that alleged in the appellee's claim for refund; further, that appellee's claim for refund does not support this suit and the Court was without jurisdiction to enter- [37]tain the causes of action on the grounds upon which the Judgment of the District Court was based.

The United States District Court further erred in holding that under the law and the evidence appellee was entitled to Judgment against appellant.

CARL C. DONAUGH,

United States Attorney.

JAMES H. HAZLETT,

Assistant United States Attorney.

THOMAS R. WINTER,

Special Assistant to the
United States Attorney.

United States of America,
District of Oregon—ss.

Service of the within Statement of Points is accepted in the State and District of Oregon this 19th day of September, 1942, by receiving a copy thereof,

duly certified to as such by James H. Hazlett, Assistant United States Attorney for the District of Oregon.

R. T. JACOB,

Of Attorneys for Plaintiff.

[Endorsed]: Filed September 19, 1942. [38]

And Afterwards, to wit, on the 19th day of September, 1942, there was duly Filed in said Court, a Designation of the contents of the record on appeal, in words and figures as follows, to wit: [39]

[Title of District Court and Cause.]

DESIGNATION OF CONTENTS OF RECORD
ON APPEAL

To the Clerk of the Above Court:

The defendant, United States of America, hereby designates the following in this case to be contained in the record on appeal:

1. Complaint.
 2. Answer.
 3. Memorandum of Decision dated June 9, 1942.
 4. Findings of Fact and Conclusions of Law.
 5. Judgment dated June 16, 1942.
 6. Notice of Appeal.
 7. Statement of Points.
 8. Pre-trial order, dated as of Feb. 17, 1942.
- Filed June 9, 1942.

9. Reporter's Original Transcript of Trial Proceedings.

10. All Original Exhibits.

11. This Designation of Contents of Record on Appeal.

CARL C. DONAUGH

United States Attorney

JAMES H. HAZLETT

Assistant United States

Attorney

THOMAS R. WINTER

Special Assistant to the United
States Attorney for the Dis-
trict of Oregon.

[Endorsed]: Filed September 19, 1942. [40]

And Afterwards, to wit, on Saturday, the 19th day of September, 1942, the same being the 65th Judicial day of the Regular July, 1942, Term of said Court; present the Honorable Claude McCulloch, United States District Judge, presiding, the following proceedings were had in said cause, to wit: [41]

[Title of District Court and Cause.]

ORDER RE EXHIBITS

Upon application of the attorney for defendant and appellant herein and good cause appearing therefor, it is hereby

Ordered that all original exhibits in this cause

be transmitted to the United States Circuit Court of Appeals for the Ninth Circuit in connection with the appeal of this case.

Dated this 19th day of September, 1942.

CLAUDE McCOLLOCH

Judge.

[Endorsed]: Filed Sept. 19, 1942. [42]

And Afterwards, to wit, on the 7th day of October, 1942, there was duly Filed in said Court, a Stipulation amending designation of contents of record, in words and figures as follows, to wit: [43]

[Title of District Court and Cause.]

STIPULATION TO AMEND "DESIGNATION
OF CONTENTS OF RECORD ON APPEAL"

It is hereby Stipulated that the "Designation of Contents of Record on Appeal" filed by defendant be amended by including therein a line to be inserted between lines 8 and 9, as follows:

"8a. Reporter's original transcript of pre-trial proceedings. Marked Exhibit 17."

Dated October 5, 1942.

S. J. BISCHOFF

Attorney for Plaintiff

THOMAS R. WINTER

[Endorsed]: Filed October 7th, 1942. [44]

Attorney for Defendant.

And Afterwards, to wit, on Tuesday, the 20th day of October, 1942, the same being the 91st Judicial day of the Regular July, 1942, Term of said Court; present the Honorable Claude McColloch, United States District Judge, presiding, the following proceedings were had in said cause, to wit: [45]

[Title of District Court and Cause.]

ORDER EXTENDING TIME FOR
DOCKETING APPEAL

This Matter coming on to be heard on motion to James H. Hazlett, Assistant United States Attorney for the District of Oregon, for an order extending the time for docketing the appeal in the above-entitled cause in the United States Circuit Court of Appeals for the Ninth Circuit, and the Court being fully advised in the premises, It Is Ordered that the defendant, United States of America, have to and including the 24th day of November, 1942, to docket its appeal in the United States Circuit Court of Appeals for the Ninth Circuit.

Dated at Portland, Oregon, this 20th day of October, 1942.

CLAUDE MCCOLLOCH
District Judge

[Endorsed]: Filed Oct. 20, 1942. [46]

And Afterwards, to wit, on Tuesday, the 24th day of November, 1942, the same being the 21st Judicial day of the Regular November, 1942, Term of said Court; present the Honorable Claude McCulloch, United States District Judge, presiding, the following proceedings were had in said cause, to wit: [47]

[Title of District Court and Cause.]

ORDER EXTENDING TIME FOR
DOCKETING APPEAL

This Matter coming on to be heard on motion of James H. Hazlett, Assistant United States Attorney for the District of Oregon, for an order extending the time for docketing the appeal in the above-entitled cause in the United States Circuit Court of Appeals for the Ninth Circuit, and the Court being fully advised in the premises, It Is Ordered that the defendant, United States of America, have to and including the 13th day of December, 1942, to docket its appeal in the United States Circuit Court of Appeals for the Ninth Circuit.

Dated at Portland, Oregon, this 24th day of November, 1942.

CLAUDE McCOLLOCH
District Judge

[Endorsed]: Filed Nov. 24, 1942. [48]

CERTIFICATE OF CLERK TO
TRANSCRIPT OF RECORD

United States of America,
District of Oregon—ss.

I, G. H. Marsh, Clerk of the District Court of the United States for the District of Oregon, do hereby certify that the foregoing pages numbered from 1 to 48 inclusive, constitute the transcript of record on appeal from a judgment of said Court in a cause therein numbered Civil 854, in which Chinook Investment Company is plaintiff and appellee, and United States of America is defendant and appellant; that said transcript has been prepared by me in accordance with the designation and stipulation amending designation of contents of the record on appeal filed therein by appellant and in accordance with the rules of Court; that I have compared the foregoing transcript with the original record thereof and that the foregoing transcript is a full, true and correct transcript of the record and proceedings had in said Court in said cause, as the same appear of record and on file at my office and in my custody, in accordance with the said designation and stipulation amending designation.

I further certify that I am transmitting with said transcript, the duplicate of the reporter's transcript filed in the Clerk's Office.

I further certify that I am transmitting to the Circuit Court of Appeals for the Ninth Circuit, pursuant to an order of the District Court of the

United States for the District of Oregon, all of the original exhibits numbered from 1 to 14-b inclusive and the original transcript of pretrial proceedings marked exhibit 17, and defendant's exhibits 15 and 16, being all of the original exhibits introduced in evidence at the trial in said cause. [49]

I further certify that the cost of the foregoing transcript is \$5.00 for filing Notice of Appeal, and \$8.10 for comparing and certifying the within transcript, making a total of \$13.10, which has not been paid by appellant but is a constructive charge against the United States.

In Testimony Whereof, I have hereunto set my hand and affixed the seal of said Court at Portland, in said District, this 1st day of December, 1942.

[Seal]

G. H. MARSH,
Clerk. [50]

[Title of District Court and Cause.]

Portland, Oregon, Tuesday, February 17, 1942,
2:14 o'clock P. M.

Before:

Honorable Claude McColloch, Judge.

Appearances:

Messrs. Robert T. Jacob and S. J. Bischoff, Attorneys for the Plaintiff;

Mr. Thomas R. Winter, Special Assistant to the Chief Counsel, Bureau of Internal Revenue, appearing for the United States of America, the Defendant.

TRIAL PROCEEDINGS

Mr. Bischoff: Shall we proceed now with the trial, your Honor?

The Court: Yes.

Mr. Bischoff: At this time I might say first, that we concluded our pre-trial procedure here at twelve o'clock and we haven't had the time to prepare a pre-trial order but we will prepare it and submit it to your Honor.

The Court: Is there any doubt of our having enough time? Could you put your oral testimony on before your documentary?

Mr. Bischoff: Well, our oral testimony will be short and we will be through.

The Court: All right.

Mr. Bischoff: I may say to your Honor, I had intended at the conclusion of our introduction of

testimony to suggest to your Honor deferring oral argument so that we could exchange briefs and then fix the time for oral argument.

The Court: Is that satisfactory, Mr. Winter?

Mr. Winter: Yes; if your Honor wants to take the case under advisement after hearing it.

The Court: Oh, I see. We will do it that way. We will follow that, which is the usual practice in tax cases—submit briefs and then hear you in oral argument.

Mr. Bischoff: At this time I offer in evidence Pre-Trial Exhibit 1, your Honor.

Mr. Winter: If the Court please, there are only two exhibits that I will make any objection to, and I would suggest, to shorten it, that all pre-trial exhibits may be introduced with the exception of those two, and those only go to materiality of something not within the issues in this case.

The Court: In other words, Mr. Winter is consenting to the [2*] introduction now of all of the pre-trial exhibits except two, which he will name in a minute, as to which he reserves exceptions, and I will admit——

Mr. Winter: I reserve the exceptions that will be reserved and set forth in the pre-trial order, your Honor.

The Court: All right.

Mr. Winter: They only go to the materiality and to the competency of one exhibit.

The Court: Here is what we have done in some

*Page numbering appearing at top of page of original Reporter's Transcript.

other tax cases. At the outset we have admitted all pre-trial exhibits in evidence, subject to the same objections as were reserved in the pre-trial order.

Mr. Bischoff: Well, that is all right, then. With that understanding I will offer all of the pre-trial exhibits.

Mr. Winter: And we make the same offer with respect to the two exhibits introduced by defendant.

Mr. Bischoff: Yes. I offer only those which the plaintiff offered, and the defendant offers those which the defendant offered.

The Court: Well, Mr. Person will mark them as trial exhibits.

(The pre-trial exhibits so offered and received were further marked "and trial" as follows:)

Plaintiff's Pre-Trial Exhibit 1: Certified copy of Income Tax Return of plaintiff for year 1936; [3]

PLAINTIFF'S PRE-TRIAL AND TRIAL EXHIBIT No. 1

Corporation Income and Excess Profits Tax Return for the Calendar Year 1936 of the Chinook Investment Company, filed March 15, 1937.

Page 1 of Return

EXCESS PROFITS TAX COMPUTATION

Item No.

1. Value of capital stock declared in capital stock tax return, etc.....	\$100,000.00
2. Net income for Excess Profits Tax Computation	\$ 22,741.85
3. Less: Dividends received credit (85% of Item 12(a) page 2).....	23,243.34
4. Balance of Net Income.....	0.00
5. Less: 10% of Item 1.....	10,000.00
6. Net income subject to Excess Profits tax (carry forward as Item 7).....	0.00

INCOME TAX COMPUTATION

Item No.

NORMAL TAX

13. Net income for tax computation (Item 29, page 2)	\$ 22,741.85
15. Less: Dividends received credit (85% of Item 12(a) page 2).....	23,073.33
17. Normal tax net income.....	0.00

SURTAX ON UNDISTRIBUTED PROFITS

23. Net income for surtax computation.....	\$ 22,741.85
28. Adjusted net income (Item 23 minus Items 24-27)	22,741.85
29. Less: Dividends paid credit.....	23,073.33
31. Undistributed Net Income.....	None
41. Total Surtax	None
42. Total Normal Tax and Surtax.....	None
44. Balance of Tax.....	None

Page 2 of Return

Date of incorporation, February 21, 1941 under the laws * * * Oregon.

The corporation's books are in care of R. S. Farrell located at 536 S. W. Front Avenue. Kind of business (in detail) Bonds, Stocks, Real Estate.

NET INCOME COMPUTATION

Gross Income

Item No.

9. Rents	\$11,728.21
11. Capital Gain or Loss (from Schedule B) (If loss, enter such loss or \$2,000, whichever is less) Loss	2,000.00
12. Dividends on stock of:	
(a) Domestic corporation sub- ject to taxation under Title 1 of Rev. Act of 1936.....	27,145.09
14. Total Income in Items 3 and 6 to 13, inclusive.....	\$ 36,873.30

DEDUCTIONS

Deductions Itemized:

15. Compensation of Officers (From Schedule C).. <td>\$ 1,200.00</td>	\$ 1,200.00
17. Repairs <td>82.01</td>	82.01
19. Interest paid <td>3,200.00</td>	3,200.00
20. Taxes Paid <td>5,050.50</td>	5,050.50
23. Depreciation <td>4,328.00</td>	4,328.00
25. Other Deductions Authorized by Law: <td>:</td>	:
(a) Expenses <td>403.47</td>	403.47
(b) Insurance <td>67.41</td>	67.41
26. Total Deductions <td>\$ 14,331.45</td>	\$ 14,331.45
<hr/>	
27. Net Income for Excess Profits Tax Compu- tation <td>\$ 22,541.85</td>	\$ 22,541.85
29. Net income for Income Tax Computation..... <td>\$ 22,541.85</td>	\$ 22,541.85

Page 3 of Return

SCHEDULE B—CAPITAL GAINS AND LOSSES

(From Sales or Exchanges Only)

1. Description of Property	2. Date Acquired	3. Date Sold	4. Gross Sales Price	5. Cost	9. Gain or Loss
Grandby Copper	5/ 2/30	12/28/36	\$ 2,363.67	\$ 9,006.25	** Loss 6,642.58
Texas Gulf Sulphur.....	4/18/29	12/23/36	7,940.64	11,497.50	** " 3,556.86
Guardian Investors	5/16/28	12/28/36	1,805.50	10,100.00	** " 8,294.50
Port. Gas & Coke.....	6/26/31 ³⁰ ₃₂	12/18/36	10,856.50	24,216.25	** " 13,359.75
Interstate Equities	12/13/28	1936	Bankrupt	3,385.00	** " 3,385.00
N. W. Electric.....	7/30/31	12/28/36	17,409.47	20,300.00	** " 2,890.53
Cat Tractor	1/ 7/29	12/ 7/36	35,534.34	31,611.84	** Gain 3,922.50
Bonds Chile	6/28/29	7/ 1/36	1,371.70	9,200.00	** Loss 7,828.30
Net Loss					

Gain or Loss (enter net amount as Item 11, page 2 if net amount is a loss, enter that amount as \$2,000.00, whichever is less).....Loss 2,000.00

SCHEDULE L—BALANCE SHEET

ASSETS

Page 5 of Return

	Beginning of Taxable Year	End of Taxable Year
4. Inventories	None	None
6. Other Investments		
(a) Stocks of Domestic corporations	\$336,603.64	\$279,601.89
(b) Bonds of Domestic corporations	56,530.50	45,878.00
	<u>393,134.14</u>	<u>325,479.89</u>

8. Capital Assets:

(a) Buildings)	
(b) Machinery and Equipment)	175,661.43
(d) Delivery Equipment		904.69
(g) Less reserves for depreciation		176,566.12
12. Total assets		547,709.31

LIABILITIES

20. Surplus	252,644.95	225,709.31
21. Undivided Profits	252,644.95	225,709.31
22. Total Liabilities	574,644.95	547,709.31

Page 6 of Return

SCHEDULE M—RECONCILIATION OF NET INCOME AND ANALYSIS OF CHANGES IN SURPLUS

Item

1. Net Income	\$ 22,541.85
3. Balance	22,541.85
4. (c) Other Items of Nontaxable Income	
(1) Capital Stock Dividend	
Alder Investment Company.....	630.00
7. Total of Lines 3 to 6, inclusive.....	\$ 23,171.85
8. Total from Line 16.....	50,107.49
9. Net profit or loss for year, as shown by books, before any adjustments are made therein (Line 7 minus Line 8) (If loss indicate).....	26,935.64
10. Surplus and undivided profits as shown by bal- ance sheets at close of preceding taxable year....	252,644.95
14. Surplus, etc. at close of taxable year.....	225,709.31
15. Unallowable Deductions	
(j) Additions to reserves for contingencies	
(1) Loss Bankrupts, etc.....	11,620.00
(1) Other unallowable deductions (to be detailed)	
(1) Excess over \$2,000.00—loss on stocks and bonds sold.....	38,487.49
16. Total of Line 15.....	50,107.49
17. Dividends paid during the taxable year (state whether paid in cash, stock of the corporation, or other property).....	None

SCHEDULE OF DIVIDENDS RECEIVED

Crown Will. Pap. Co.—San Fran.....	728.
American Snuff—Memphis	975.
Texas Gulf Sulphur, N. Y.....	1500.
Pacific Ltg. Co.—Los A.....	300.
Caterpillar Tractor—San Leandro.....	7500.
Iron Fireman—Portland	2527.50
Supervised Shares—Jersey Cy.....	520.50
Kennecott Copper—N. Y.....	340.

Magma Copper—N. Y.....	275.
Petrol. Corp. of Amer., Jersey Cy.....	270.
Transamerica, S. Fran.....	400.
Oregon Worsted, Portland.....	60.
Sperry Corp.—N. Y.....	300.
Peoples Water & Gas—N. Y.....	675.
Anaconda Copper—N. Y.....	125.
Pickle Crow Min. Co.—Toronto.....	19.50
Trans. & West. Air—Kansas Cy.....	6.
Pacific International, Portland.....	550.
N. W. Electric, Portland.....	7056.
Quarterly Shares—Jersey Cy.....	150.
Incorporated Invest., Boston.....	2166.96
Equity Corp.—Jersey Cy.....	473.13
Central & S. W. Utilities.....	227.50
	<hr/>
	127145.09
	<hr/>

[Endorsed]: Filed Dec. 7, 1942.

Plaintiff's Pre-Trial Exhibit 2: Certified copy of letter dated March 2nd, 1937, addressed to Chinook Investment Company;

PLAINTIFF'S PRE-TRIAL AND TRIAL
EXHIBIT No. 2

TREASURY DEPARTMENT
Internal Revenue Service
Portland, Oregon

March 2, 1937

Chinook Investment Co.
536 SW First Ave.
Portland, Oregon

Gentlemen:—

Receipt is acknowledged of your 1936 Corporation Income and Excess Profits Tax Return.

The return discloses a net income of \$22,541.85. However, you failed to compute the tax liability. The computation is shown below. Kindly forward remittance in payment of all, or at least one-quarter of the tax, on or before March 15, 1937.

J. W. MALONEY, Collector.

INCOME TAX COMPUTATION

Note—Line numbers refer to lines of Form 1120, Page 1

Normal Tax:

13.	Net income for income tax computation.....		\$22,541.85
14.	Less: Interest on obligations of U. S.....\$.....		
15.	Dividends received credit.....\$23,073.33		\$23,073.33
17.	Normal tax on net income.....	none	
Portion of Item 17. Rate			
18.	Tax on por. Item 17 not in excess of \$2000.00.....	8%	\$.....
19.	Tax on por. Item 17 in excess \$2000 and not in excess of \$15,000.....	11%
20.	In excess \$15,000 and not in excess of \$40,000.....	13%
21.	In excess of \$40,000.....	15%
22.	Total Normal Tax.....		\$.....

INCOME TAX COMPUTATION (Continued)

Surtax on Undistributed Profits:

23.	Net income for surtax computation.....	\$22,541.85
24.	Less: Normal tax (Item 22).....\$.....	
25.	Int. on U. S. Obligat. etc.	\$.....
28.	Adjusted Net Income.....	\$22,541.85
29.	Less: Dividends paid credit.....\$.....	
30.	Cr. for contracts restricting div. payments\$.....	\$.....
31.	Undistributed Net Income.....	\$22,541.85
32.	Less Specific Credit.....	\$ 2,745.81
33.	Remainder subject to surtax (Item 31 minus Item 32).....	\$19,796.04

INCOME TAX COMPUTATION (Continued)

	Portion of Item 33	Rate	
34. Tax on por. of Item 33 not in excess of 10% of Item 28.....	\$ 2,254.19	7%	\$ 157.79
35. Tax on por. of Item 33 in excess of 10% and not in excess of 20% of Item 28.....	\$ 2,254.19	12%	\$ 270.50
36. Tax on por. of Item 33 in excess of 20% and not in excess of 40% of Item 28.....	\$ 4,508.38	17%	\$ 766.42
37. Tax on por. of Item 33 in excess of 40% and not in excess of 60% of Item 28.....	\$ 4,508.38	22%	\$ 991.83
38. Tax on por. of Item 33 in excess of 60% of Item 28.....	\$ 6,270.90	27%	\$ 1,693.14
39. Amount of tax in Items 34 to 38, inclusive.....			\$ 3,879.68
40. Plus 7% of amount of specific credit (Item 32).....			\$ 192.21
41. Total Surtax (Item 39 plus Item 40).....			\$ 4,071.89
42. Total Normal Tax and Surtax (Item 22 plus Item 41).....			<u>\$ 4,071.89</u>

[Endorsed]: Filed April 24, 1942.

Plaintiff's Pre-Trial Exhibit 3: Certified copy of claim for refund of \$4,071.89, received by Collector February 18, 1938;

PLAINTIFF'S PRE-TRIAL AND TRIAL
EXHIBIT No. 3

The tax on corporate undistributed profits as levied upon the claimant corporation and collected is illegal, for:

I

The purpose and legislative intent of the surtax on undistributed profits was to impose a levy on those corporations which permitted their earnings and profits to accumulate in the corporate coffers without distribution to the shareholders, so as to equalize the burden of taxation between the corporations and shareholders who received regular dividends subject to annual taxation on the one hand, and those corporations and shareholders who could afford to permit their corporate earnings to accumulate and escape current surtaxes on the other hand.

In his special message to Congress on March 3, 1936, the President stated:

“The accumulation of surplus in corporations controlled by taxpayers with large incomes is encouraged by the present freedom of undistributed corporate income from surtaxes. Since stockholders are the beneficial owners

Plaintiff's Pre-Trial and Trial Exhibit 3—(Cont.)

of both distributed and undistributed corporate income, the aim, as a matter of fundamental equity, should be to seek equality of tax burden on all corporate income whether distributed or withheld from the beneficial owners. As the law now stands our corporate taxes dip too deeply into the shares of corporate earnings going to stockholders who need the disbursement of dividends, while the shares of stockholders who can afford to leave earnings undistributed escape current surtaxes altogether.

“This method of evading existing surtaxes constitutes a problem as old as the income-tax law itself. Repeated attempts by the Congress to prevent this form of evasion has not been successful. The evil has been a growing one. It has now reached disturbing proportions from the standpoint of the inequality it represents and of its serious effect on the Federal revenue. Thus the Treasury estimates that, during the calendar year 1936, over 4½ billion dollars of corporate income will be withheld from stockholders. If this undistributed income were distributed, it would be added to the income of stockholders and there taxed as is other personal income. But, as matters now stand, it will be withheld from stockholders by those in control of these corporations. In one year alone, the Government will be deprived

Plaintiff's Pre-Trial and Trial Exhibit 3—(Cont.)
of revenues amounting to over \$1,300,000,000.

“A proper tax on corporate income (including dividends from other corporations), which is not distributed as earned, would correct the serious twofold inequality in our taxes on business profits if accompanied by a repeal of the present corporate income tax, the capital-stock tax, the related excess-profits tax, and the present exemption of dividends from the normal tax on individual incomes. The rate on undistributed corporate income should be graduated and so fixed as to yield approximately the same revenue as would be yielded if corporate profits were distributed and taxed in the hands of stockholders.

“Such a revision of our corporate taxes would effect great simplification in tax procedure, in corporate accounting, and in the understanding of the whole subject by the citizens of the Nation. It would constitute distinct progress in tax reform.”

In the Report of Mr. Doughton, Chairman of the House of Representatives Committee on Ways and Means, representing the majority views, the following purposes were started (P. 3.):

“The President requests the Congress to raise 620 million dollars of additional revenue annually by some form of permanent taxation. He suggests some form of undistributed profits tax. Your committee recognizes the fact that

Plaintiff's Pre-Trial and Trial Exhibit 3—(Cont.)

the greatest defect in our present system of taxation lies in the fact that surtaxes on individuals are avoided by impounding income in corporate surpluses. Therefore, your committee proposes a plan of taxation which taxes a corporation on the net income, but which fixes the rate in accordance with the proportion of the net income undistributed.

“The major purposes of the change in the method of taxing corporate incomes are (1) to prevent avoidance of surtax by individuals through the accumulation of income by corporations, (2) to remove serious inequities and inequalities between corporate, partnership, and individual forms of business organization, and (3) to remove the inequity as between large and small shareholders resulting from the present flat corporate rates.

“It is well recognized that the corporate form of doing business enjoys certain advantages over individual and partnership businesses. The existing law creates purely artificial additional advantages in some cases and artificial disadvantages in others, depending upon the size of the enterprise and the character of its ownership. Individuals and partnerships cannot minimize their taxes by failure to distribute their business earnings. Corporations should not be permitted to withhold from the beneficial shareholders unneeded corporate income at the ex-

Plaintiff's Pre-Trial and Trial Exhibit 3—(Cont.)

pense of the revenues of the United States and to the detriment of the shareholder. The bill proposes to remove many of these inequities by relieving from tax corporations which distribute all their net earnings annually as earned, and by taxing corporations accumulating their net income at a rate to compensate to a large extent for the amount of tax on the shareholders' income lost by reason of the failure to make a complete distribution. Adequate safeguards are provided in the bill to prevent unreasonable taxation of incomes in the case of corporations in distress or with inadequate earnings to take care of their immediate business needs. No attempt is made under the bill to tax past accumulations of surplus.- - -"

And on Page 8 of the Report, the majority stated:

"This new plan of taxing corporate net income, in the opinion of your committee, will not prevent the retention of earnings sufficient to provide for legitimate corporate needs but will discourage accumulation for which there is no sound reason.- - -"

The entire income of the claimant corporation after applying expenses against other income, was derived from dividends, and, therefore, was not subject to normal taxation under the Revenue Act of 1936. The Majority Report by Mr. Doughton continued (P. 11):

Plaintiff's Pre-Trial and Trial Exhibit 3—(Cont.)

“Your committee is of the opinion that corporations which are exempt from the income tax under existing law should not be subject to the proposed plan for taxing corporations. Corporations paying dividends to such corporations receive the same dividend credit as if such dividends were paid to persons not exempt from the income tax.”

The Senate modified the provisions of the House Bill 12395, but retained the principal feature of taxing the corporate undistributed profits. The Senate Finance Committee saw that the evil sought to be remedied was “the retention of profits by corporations to protect investors having large incomes against paying on large incomes”, and modeled its revision along those lines.

The Bill, as finally enacted, provided for such tax on the undistributed profits of corporations, and stated in Section 14 (b):

“Imposition of Tax.—There shall be levied, collected, and paid for each taxable year upon the net income of every corporation a surtax equal to the sum of the following, subject to the application of the specific credit as provided in subsection (c):

7 per centum of the portion of the undis-
tributed net income which is not in excess
of 10 per centum of the adjusted net in-
come. - - -”

According to Section 14 (a) (1), “the term ‘ad-

Plaintiff's Pre-Trial and Trial Exhibit 3—(Cont.)
justed net income' means the net income minus the sum of—

(A) The normal tax imposed by section 13.

(B) The credit provided in section 25 (a), relating to interest on certain obligations of the United States and Government corporations.

(C) In the case of a holding company affiliate (as defined in section 2 of the Banking Act of 1933), the amount allowed as a credit under section 26 (d).

(D) In the case of a national mortgage association created under Title III of the National Housing Act, the amount allowed as a credit under section 26 (e)."

And according to Section 14 (a) (2), "The term 'undistributed net income' means the adjusted net income minus the sum of dividends paid credit provided in section 27 and the credit provided in section 26 (c), relating to contracts restricting dividends."

The claimant corporation sustained an *actual* net loss of \$19,493.17, but due to the \$2,000 limitation imposed by Section 117 (d) of the Revenue Act of 1936 on a net capital loss of \$42,035.02, the net result was distorted so as to indicate a net profit of \$22,541.85 for the calendar year 1936. The Collector of Internal Revenue levied and collected an additional tax based upon the failure to distribute the nonexistent profit, on the theory that since the

Plaintiff's Pre-Trial and Trial Exhibit 3—(Cont.) net income was computed to be \$22,541.85 and since there were no deductions for purposes of the surtax on undistributed profits, that sum constituting the net income was also the "undistributed net income" and, therefore, was subject to the surtax imposed by Section 14 of the Revenue Act of 1936. The net result of the operations of the year left the claimant with no actual net income, as the term is used by accountants and understood generally. In view of the foregoing expressions of legislative intent, it is submitted that Section 14 was not designed to be imposed upon a statutory net income regardless of the actualities of the situation. Some variation between statutory net income and net income in the accounting sense may be permissible, but not a variation which taxes the failure to distribute that which was completely nonexistent.

II.

The provisions of Section 14 of the Revenue Act of 1936 are unconstitutional and violate the Fifth Amendment to the Constitution of the United States insofar as they set up an arbitrary basis of incidence as applied to the claimant corporation by taxing as "undistributed net income" an amount that is actually nonexistent as income of any character whatsoever.

The Fifth Amendment to the Constitution of the United States provides in part as follows:

"No person shall - - - be deprived of life, lib-

Plaintiff's Pre-Trial and Trial Exhibit 3—(Cont.)

erty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.”

The Supreme Court regards the due process clauses of the Fifth and Fourteenth Amendments as exact counterparts, despite the difference between the active and passive voice,—*Carroll v. Greenwich Insurance Co.*, 199 U.S. 401, 410, 26 S.Ct. 66, 50 L.Ed. 246 (1905); *Hamilton v. Kentucky Distilleries and Warehouse Co.*, 251 U.S. 146, 156, 40 S.Ct. 106, 64 L. Ed. 194 (1919); 29 *Columbia Law Review* 624, 625, —and the citations are interchangeable. 29 *Columbia Law Review* 321, n. 9, and cases therein cited.

These amendments have been held to apply to corporations as well as individuals. *The Railroad Tax Cases*, 13 Fed. 722, 746; *Portland Railway, Light and Power Co. v. Railroad Commission*, 56 Or. 468, 109 Pac. 273.

The Supreme Court has held that the Fifth Amendment is not only a procedural guaranty, but also a guaranty of substantive due process, the test of which is the reasonableness or arbitrariness of incidence. Mr. Justice Brandeis in the dissenting opinion in *Burnet v. Coronado Oil & Gas Co.*, 285 U.S. 393, 410, 52 S.Ct. 443, 76 L.Ed. 815.

In *Heiner v. Donnan*, 285 U.S. 312, 52 S.Ct. 358, 10 AFTR 1609, the Supreme Court, in dealing with the statutory conclusive presumption that transfers made without consideration within two years of the donor's death were made in contemplation of death,

Plaintiff's Pre-Trial and Trial Exhibit 3—(Cont.) held that this provision of the Revenue Act of 1926 ran afoul of the Fifth Amendment, *supra*. The Court cited *Schlesinger v. Wisconsin*, 270 U.S. 230, 46 S.Ct. 260, 70 L.Ed. 557, 43 A.L.R. 1224, which involved a similar statute of Wisconsin which was held unconstitutional under the due process clause of the Federal Constitution. The Court proceeded to state:

“The *Schlesinger* Case has since been applied many times by the lower federal courts, by the Board of Tax Appeals, and by state courts; and none of them seem to have been at any loss to understand the basis of the decision, namely, that a statute which imposes a tax upon an assumption of fact which the taxpayer is forbidden to controvert is so arbitrary and unreasonable that it cannot stand under the Fourteenth Amendment.

“Nor is it material that the Fourteenth Amendment was involved in the *Schlesinger* Case, instead of the Fifth Amendment, as here. The restraint imposed upon legislation by the due process clauses of the two amendments is the same. *Coolidge v. Long*, 282 U.S. 582, 596, 51 S.Ct. 306, 75 L.Ed. 562. That a federal statute passed under the taxing power may be so arbitrary and capricious as to cause it to fall before the due process of law clause of the Fifth Amendment is settled. *Nichols v. Coolidge*, 274 U.S. 531, 542, 47 S.Ct. 710, 71 L.Ed.

Plaintiff's Pre-Trial and Trial Exhibit 3—(Cont.)
1184, 52 A.L.R. 1081; *Brushaber v. Union Pac. RR Co.*, 240 U.S. 1, 24-25, 36 S.Ct. 236, 60 L.Ed. 493, L.R.A. 1917D, 414 Ann. Cas. 1917B, 713; *Tyler v. United States*, *supra*, 281 U.S. 504, 50 S.Ct. 356, 74 L.Ed. 991, 69 A.L.R. 758."

Professor Robert Murray Haig has defined income as follows (*The Federal Income Tax* (Columbia University Lectures), p. 27):

"Income is the money value of the net accretion to economic power between two points of time."

In the case at hand, the claimant corporation realized no net accretion to economic power between January 1, 1936 and December 31, 1936, but did realize a net decrease in economic power valued at \$19,493.17. This is the actual fact. In *Hoeper v. Commissioner*, 284 U.S. 206, 52 S.Ct. 120, 76 L.Ed. 248, the Supreme Court in applying the Fourteenth Amendment to the Wisconsin statute said:

"- - -That which is not in fact the taxpayer's income cannot be made such by calling it income. Compare *Nichols v. Coolidge*, 274 U.S. 531, 47 S.Ct. 710, 71 L.Ed. 1184, 52 A.L.R. 1081."

Nor can that which is not profit constitute undistributed profits.

Taxation is a practical matter, and fiction may not be permitted to obscure the realities. United

Plaintiff's Pre-Trial and Trial Exhibit 3—(Cont.)
States v. Flannery, 268 U.S. 98, 45 S.Ct. 420. In the latter case, the Supreme Court said:

“Since Flannery sustained no actual loss in the transaction in question, having sold the stock for more than it had cost, his executors were not entitled to the deduction which they claimed because it was sold at less than its market value on March 1, 1913.” (Emphasis ours.)

As was stated by Ernst Fuchs (*Wurttembergische Zeitung fur Rechtspflege und Verwaltung*, p. 5, (1909)):

“What we are striving for is that the courts may find the right judgment on the merits by practical sense and true comprehension of the facts, instead of the correct logical deduction by the help of scholastic subtleties.”

See also *Farmers' Loan & Trust Co. v. State of Minnesota*, 280 U.S. 204, 50 S.Ct. 98, 74 L.Ed. 371, 8 AFTR 10257, where the Court said plainly:

“Taxation is an intensely practical matter, and laws in respect of it should be construed and applied with a view of avoiding, so far as possible, unjust and oppressive consequences.- - -”

In accord, *Jacobs v. Commissioner*, 34 F.(2d) 233, 235, certiorari denied, 280 U.S. 603, 50 S.Ct. 85, 74 L.Ed. 647; *City Bank Farmers Trust Co., Ex'r v. U.S.*, 74 F.(2d) 692 (C.C.A. 2d, 1935); *Irving D. Rossheim*, 31 B.T.A. 857, 867; *Dudley T. Humphrey*, 32 B.T.A. 280, 282.

Plaintiff's Pre-Trial and Trial Exhibit 3—(Cont.)

Divorced from realty taxation becomes sheer oppression. When the provisions of Section 14, *supra*, are applied to a taxpayer with an actual loss, they penalize "a lifeless stone for not yielding milk". "Such an exaction is not taxation but spoliation." *Heiner v. Donnan*, *supra*.

In the *Heiner v. Donnan* case, *supra*, the government counsel maintained that the conclusive presumption created by the statute was a rule of substantive law, and, regarded as such, should be upheld. The Court dismissed this contention completely by saying:

"- - it is hard to see how a statutory rebuttable presumption is turned from a rule of evidence into a rule of substantive law as the result of a later statute making it conclusive. In both cases it is a substitute for proof; in the one open to challenge and disproof, and in the other conclusive. However, whether the latter presumption be treated as a rule of evidence or of substantive law, it constitutes an attempt by legislative fiat, to enact into existence a fact which here does not, and cannot be made to, exist in actuality, and the result is the same, unless we are ready to overrule the *Schlesinger Case*, as we are not; for that case dealt with a conclusive presumption, and the court held it invalid without regard to the question of its technical characterization. This court has held more than once that a statute creating a pre-

Plaintiff's Pre-Trial and Trial Exhibit 3—(Cont.)

sumption which operates to deny a fair opportunity to rebut it violates the due process clause of the Fourteenth Amendment. For example, *Bailey v. Alabama*, 219 U.S. 219, 238, et seq., 31 S.Ct. 145, 55 L.Ed. 191; *Manley v. Georgia*, 279 U.S. 1, 5-6, 49 S.Ct. 215, 73 L.Ed. 575. "It is apparent," this court said in the *Bailey Case* (219 U.S. 239, 31 S.Ct. 145, 151, 55 L.Ed. 191) "that a constitutional prohibition cannot be transgressed indirectly by the creation of a statutory presumption any more than it can be violated by direct enactment. The power to create presumptions is not a means of escape from constitutional restrictions."

"If a legislative body is without power to enact as a rule of evidence a statute denying a litigant the right to prove the facts of his case, certainly the power cannot be made to emerge by putting the enactment in the guise of a rule of substantive law."

In *Williams Investment Co. v. United States*, 3 Fed. Supp. 225, 12 AFTR 671 (Ct. of Claims, 1933), the Court of Claims dealt with the constitutionality of the surtax on corporations formed or availed of to avoid surtax on their stockholders, which differs from the provisions of Section 14, *supra*, in effect only insofar as it makes the presumption conclusive that the corporation is availed of for the purpose of avoiding the surtax on divi-

Plaintiff's Pre-Trial and Trial Exhibit 3—(Cont.)
dends. The Court upheld the statute because the presumption was merely *prima facie*, and said:

“The section does not make the accumulation of surplus an absolute test for classification, but merely a *prima facie* classification. It does not tax all corporations which accumulate their surplus, but classifies those as subject to the tax who make such accumulations for the purpose of preventing the imposition of the surtax on their stockholders, leaving each corporation free to establish as a fact, if such be the fact, that the accumulation was for the needs of the business. The presumption is not conclusive.”

The purpose of the tax, according to the court, was “to aid in the collection of revenue” and to prevent evasions of the tax laws. As applied to corporations with an actual net income, it accomplished its purpose. In all the cases to which it has been applied, the corporation has had an actual net income which was withheld from its stockholders. But in the case at hand the analogous statute is being applied to a corporation with an operating deficit in fact. There was no net income to distribute to stockholders. Yet the statute makes the *prima facie* presumption of Section 220 of the Revenue Acts of 1924 and 1926 a substantive rule of law, thus embalming the *prima facie* presumption into a conclusive presumption. *Heiner v. Donnan*, *supra*, dealing with a case nearly on all fours, de-

Plaintiff's Pre-Trial and Trial Exhibit 3—(Cont.)
spatched swiftly and thought of the constitutionality of such statute.

The conclusion follows in the matter at hand that by enacting a rule of substantive law that a statutory "undistributed net income" should be subject to taxation regardless of whether such "net income" existed, much less whether there was any to distribute, Congress attempted, "by legislative fiat, to enact into existence a fact which here does not, and cannot be made to exist in actuality." *Heiner v. Donnan*, *supra*. Such legislation, by virtue of its arbitrary incidence, violates the Fifth Amendment to the Constitution of the United States and is void.

III.

The provisions of Section 14 of the Revenue Act of 1936 are unconstitutional under Article 9 and the Sixteenth Amendment, for, they impose a tax not on the receipt of income but on its non-disposition, thus taxing the unspent portion of corporate money without apportionment.

The Sixteenth Amendment to the Constitution of the United States provides as follows:

"The congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration."

The other pertinent provisions of the Constitution of the United States are as follows:

Plaintiff's Pre-Trial and Trial Exhibit 3—(Cont.)

"Art. 8. Powers of congress.—The congress shall have power—

To lay and collect taxes, duties, imposts and excises, to pay the debts and provide for the common defense and general welfare of the United States; but all duties, imposts and excises shall be uniform throughout the United States.

- - -

"Art. 9. Restrictions upon powers of congress.—

- - -

"No capitation, or other direct, tax shall be laid, unless in proportion to the census or enumeration hereinbefore directed to be taken."

A tax on the unspent portion of corporate income is a direct tax. This unspent portion constitutes property which cannot be levied upon without due process of law. *Heiner v. Donnan*, supra. In *Pollock v. Farmers' Loan & Trust Co.*, 157 U.S. 429, 15 S.Ct. 673, (1895), a bill was brought by a stockholder in the defendant corporation to enjoin the payment of a tax of two percent on the net profits of the corporation for the year 1894. The bill alleged that defendant's income was derived from real estate, bonds of the city of New York, and corporate bonds and stock. Unconstitutionality of the act was alleged. A demurrer on the ground of want of equity was sustained by the Circuit Court,

Plaintiff's Pre-Trial and Trial Exhibit 3—(Cont.) and on appeal to the Supreme Court of the United States the decree below was reversed. The Court said:

“- - but a tax upon property holders in respect of their estates, whether real or personal, or of the income yielded by such estates, and the payment of which cannot be avoided, are direct taxes.- -” (Emphasis ours.)

On re-argument the Court added (158 U.S. 601, 15 S.Ct. 912):

“Our previous decision was confined to the consideration of the validity of the tax on the income from real estate, and on the income from municipal bonds. The question thus limited was whether such taxation was direct or not, in the meaning of the Constitution; and the court went no further, as to the tax on the income from real estate, than to hold that it fell within the same class as the source whence the income was derived, that is, that a tax upon the realty and a tax upon the receipts therefrom were alike direct; while as to the income from municipal bonds, that could not be taxed because of want of power to tax the source, and no reference was made to the nature of the tax as being direct or indirect.

“We are now permitted to broaden the field of inquiry, and to determine to which of the two great classes a tax upon a person's entire income, whether derived from rents or products,

Plaintiff's Pre-Trial and Trial Exhibit 3—(Cont.)

or otherwise, of real estate, or from bonds, stocks, or other forms of personal property, belongs; and we are unable to conclude that the enforced subtraction from the yield of all the owner's real or personal property, in the manner prescribed, is so different from a tax upon the property itself, that it is not a direct, but an indirect tax, in the meaning of the Constitution.- - -

“The Constitution prohibits any direct tax, unless in proportion to numbers as ascertained by the census; and, in the light of the circumstances to which we have referred, is it not an evasion of that prohibition to hold that a general unapportioned tax, imposed upon all property owners as a body for or in respect of their property, is not direct, in the meaning of the Constitution, because confined to the income therefrom?”

If a tax on the income is a direct tax, then, a fortiori, a tax on a statutory retained income which already has been subjected to the income tax is a direct tax. By constitutional amendment the income tax need no longer be apportioned. But this broadening of Congressional power did not extend to other direct taxes, which must still be apportioned according to the most recent census.

The surtax on undistributed profits is levied only upon corporations, and is not apportioned among the states according to population. In the case at

Plaintiff's Pre-Trial and Trial Exhibit 3—(Cont.) hand, although there was no actual undistributed net income the tax could not be avoided. Since it is a direct tax, the conclusion follows that it is unconstitutional in its manner of imposition.

Wherefore, the claimant prays that this claim be allowed.

[Endorsed]: Filed Dec. 7, 1942.

Plaintiff's Pre-Trial Exhibit 4: Certified copy of Amended Claim for Refund of \$4,071.89, received by Collector June 30, 1939, together with letter dated September 20, 1939, addressed to Chinook Investment Company, disallowing the claim;

PLAINTIFF'S PRE-TRIAL AND
TRIAL EXHIBIT No. 4

AMENDED CLAIM FOR REFUND

The tax on corporate undistributed profits was improperly levied upon the claimant corporation and is illegal for the following reasons:

I

The purpose of the act was to compel distribution of earnings and profits

1. To prevent tax avoidance by stockholders.
2. To put money in circulation.

1. Dividends are taxable as income to the stockholders only when paid out of gains or profits

or out of surplus accumulated since February 28, 1913. There were no gains or profits for the taxable year in the case at bar and the stockholders would have been subjected to tax only on the theory that any distribution made would have been out of previously acquired surplus, which was not otherwise subject to tax, even though undistributed.

2. The money sought to be put in circulation was gains and profits. The act was not expressly made retroactive and should not be construed to affect previously accumulated gains and profits.

It will be seen, therefore, that a tax in the case at bar does not accomplish the purpose of the act, as in this case there were actually no gains or profits to be retained or distributed.

II

The statute must be construed together and all of its parts must be considered to determine the legislative intent.

1. The act described the tax as a tax on undistributed profits. If Congress had intended to impose a tax on undistributed statutory net income, regardless of whether in fact there was any actual income, it did not indicate any such intention in the title of the act. Words should be taken in their plain and accepted meaning. Revenue acts are to be strictly construed against the government. A tax expressly designed to reach undistributed profits has no application where there are no profits.

2. The tax is imposed upon net income in an amount measured by the undistributed net income. If the tax had been expressly imposed upon undistributed gains and profits, it would undoubtedly have been a direct tax and in violation of the United States constitution. For that reason it was expressly imposed on net income but in order to effect the plain purpose of the act the rate was made to depend upon the gains and profits not distributed. Where there are no gains and no profits, which could be construed to mean undistributed income, as in the claimant corporation's case there is no measure for the tax and none was intended to be imposed.

3. In determining the undistributed net income, the act allows a deduction for dividends paid, but only when paid out of earnings or profits. The deduction for dividends paid is part of the same act and that section must be construed with the one imposing the tax. The deduction was allowed obviously so that corporate income distributed should not be made subject to tax in order to encourage such distributions. The income sought to be taxed, therefore, was that available for distribution which was retained. Dividends may be paid only out of gains or profits. When they are subject to tax, the taxing act applies only when there are such gains or profits, and when capital losses exceed such gains and profits in the taxable year, it has been held that such losses reduce the income available for distribution in that year so

as to eliminate the tax, unless such distribution may be construed to have been made out of previously accumulated earnings and profits. Similarly, the deduction for dividends distributed is limited to earnings and profits, either acquired in the taxable year or previously accumulated. The claimant corporation did have a previously acquired surplus and would have been entitled to a dividend paid credit if a distribution had been made but it is a violation of the spirit and purpose of the act to make the incidence of the tax depend upon the distribution or failure to distribute such a previously acquired surplus. In no sense could such surplus be held income of the corporation in the tax year to which the act refers.

It seems clear when all provisions of the act are considered that the undistributed profits tax was intended to reach only such income as was subject to distribution as dividends and then only in the event it was not distributed. In order to tax gains and profits which in this case do not exist, it is necessary to disregard the title, scheme and purpose of the act as expressly set out by Congress. It is submitted, therefore, that capital losses must enter into the computation to fix the gains and profits subject to tax.

III

The capital losses incurred by the claimant corporation are deductible in full as having been incurred in the normal course of business by a regular dealer in stock and securities.

1. The Chinook Investment Company under its charter is empowered to buy and sell stocks and bonds and transact business usually transacted by a credit or finance company, to purchase, rent, drain, improve, cultivate and sell lands; to construct and maintain buildings, streets, railroads and street railroads leading to its properties, to deal in franchise for public utilities and to prospect and mine for mineral deposits.

2. The corporation maintains regular offices and has employees who devote substantial portions of their time to the corporate business of buying and selling and operating investments.

3. Numerous purchases and sales of securities are made by the corporation in the regular course of business and all purchases are made for the purpose of resale at a profit.

IV

The provisions of Section 14 of the Revenue Act of 1936 violate the Fifth Amendment to the Constitution of the United States insofar as they set up an arbitrary basis of incidence as applied to the claimant corporation by taxing as undistributed net income an amount which is actually non-existent as income of any character whatever.

V

The provisions of Section 14 of the Revenue Act of 1936 violate Article 9 and the Sixteenth Amendment to the Constitution of the United States in that they impose a tax not on the receipt of

net income but on its non-disposition, thus constituting a direct tax, without apportionment, on the unspent portion of corporate money.

VI

The provisions of Section 14 of the Revenue Act of 1936 violate the Tenth Amendment to the Constitution of the United States in that they attempt to regulate the internal affairs of corporations created by the states and constitute the exercise of powers not delegated to Congress.

Wherefore, the claimant prays that this claim be allowed.

[Endorsed]: Filed April 24, 1942.

Plaintiff's Pre-Trial Exhibit 5: Certified copy of Income Tax and Excess Profits Tax Return for 1937, filed by Chinook Investment Company;

PRE-TRIAL AND TRIAL EXHIBIT No. 5

Corporation Income and Excess Profits Tax Return for the Calendar Year of 1937 of the Chinook Investment Company, filed March 9, 1938.

Kind of business: Real Estate, Stocks and Bonds.

Page 1 of Return

EXCESS PROFITS TAX COMPUTATION

Item

1. Net income for Excess Profits Computation.....	\$ 15,113.50	
2. Value of Capital Stock.....	\$122,500.00	
3. Ten percent of Item 2.....	12,250.00	
4. Dividends received credit (85% of Schedule F, Column 2).....	21,460.26	33,710.26
8. Total Excess Profits Tax.....		None

NORMAL TAX COMPUTATION

9. Net income for income tax computation.....	15,113.50	
10. Dividends received credit (85% of Schedule F, Column 2).....	21,410.40	
12. Balance subject to normal tax.....		None
17. Total normal tax.....		None

UNDISTRIBUTED PROFITS SURTAX COMPUTATION

23. Net income for income tax computation.....	\$ 15,113.50	
24. Normal Tax	None	
26. Adjusted Net Income.....	15,113.50	
27. Dividends paid credit.....	10,000.00	
29. Undistributed net income.....	5,113.50	
30. Portion of Item 29 taxable at 7%.....	5,000.00 7%	350.00
31. Portion of Item 29 taxable at 12%.....	113.50 12%	13.62
35. Total Surtax		363.62
40. Total Tax Due.....		363.62

Page 2 of Return

SCHEDULE A—NET INCOME COMPUTATION
GROSS INCOME

Item

7. Interest on loans, etc.....	180.00
9. Rents	18,418.91
11. Capital Gain (or loss) (from Schedule E).....	*2,000.00
12. Dividends	25,188.70
14. Total Income	41,787.61

*Represents loss.

DEDUCTIONS

Item

18. Repairs	\$ 1,774.72
20. Interest	8,726.37
21. Taxes	9,829.72
24. Depreciation	5,212.87
26. Other deductions	1,130.43
27. Total Deductions	26,674.11
<hr/>	
28. Net income for excess profits computation.....	\$ 15,113.50
29. Less Federal excess profits tax.....	None
30. Interest on obligations of United States.....	None
31. Net income for income tax computation.....	\$ 15,113.50

SCHEDULE B—RECONCILIATION OF NET INCOME
AND ANALYSIS OF EARNED SURPLUS AND UN-
DISTRIBUTED PROFITS

1. Total distribution to stockholders charged to earned surplus during the taxable year.....	\$ 10,000.00
3. Federal Income taxes.....	4,072.00
10. Excess of capital loss, if any, over amount, al- lowable as a deduction in Item 11, Schedule A	18,652.79
15. Earned surplus and undivided profits as shown by balance sheet at close of taxable year (Schedule N)	208,899.19
<hr/>	
16. Total	241,623.98
17. Earned surplus (etc) close of preceding tax- able year	225,709.31
18. Net income for income tax computation.....	15,113.50
19. Other nontaxable dividend.....	742.50
" " "	54.17
" " "	4.50
<hr/>	
23. Total	241,623.98

SCHEDULE M—DISTRIBUTIONS TO STOCKHOLDERS
AND DIVIDENDS PAID CREDIT

Page 4 of Return

1. Cash	\$ 10,000.00
10. Total of Items 1 to 9.....	10,000.00

Dividends Paid Credit

11. Taxable distributions	10,000.00
13. Dividends paid credit.....	10,000.00
14. Adjusted net income.....	15,172.17

15. Dividend carry-over	5,172.17
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Reconciliation

16. Total distribution out of earnings, etc.....	10,000.00
17. Total distribution charged to earned surplus, etc.	10,000.00
18. Total distribution during taxable year.....	10,000.00

SCHEDULE N—BALANCE SHEETS

Page 5 of Return

ASSETS	Amount	Beginning of Taxable Year	Amount	End of Taxable Year
		Total		Total
1. Cash		\$45,663.30		\$13,586.16
6. Other Investments				
(a) Stocks of domestic cor- porations	279,601.89			
(b) Bonds of domestic cor- porations	45,878.00			
(c) All other in- vestments or loans		325,479.89		304,195.32
8. Capital Assets				
(a) Bldgs & land	175,661.43		294,913.36	
(d) Delivery equip- ment	904.69		679.69	
(g) Less re- serve for deprecia- tion		176,566.12		295,593.05
10. Total Assets		547,709.31		613,374.52

LIABILITY AND CAPITAL

19. Earned surplus and undivided profits	225,709.31		208,899.19
20. Total liabilities and capital	547,709.31		613,374.62

SCHEDULE P—NATURE OF BUSINESS

Page 6 of Return

NONMANUFACTURING

Finance

- (x) Investment trusts, stock syndicate,
stock holding corporation

CHINOOK INVESTMENT CO.

CAPITAL GAINS AND LOSSES

Description	Date Acquired	Sale Price	Cost	Loss or Gain
Stock—Bankers Trustec	4/22/29	311.50	3,515.69	(3,204.19)
Stock—Transamerica	11/23/36	3,278.93	4,623.21	(1,344.28)
Stock—Iron Fireman	11/26/36	7,475.90	10,769.60	(3,293.70)
Stock—Pickle Crow Min. Co.....	4/ 6/36	1,018.42	1,229.06	(210.64)
Stock—Pullman Co.	12/ 7/36	5,665.98	12,721.05	(7,055.07)
Stock—Standard Oil of Cal.....	1/22/37	3,220.18	4,570.75	(1,350.57)
Stock—Briggs Co.	1/ 7/37	1,301.72	2,704.80	(1,403.08)
Stock—Texas Corp.	1/28/37	4,223.91	5,248.40	(1,024.49)
Stock—N. W. Public Service Co.....	8/20/31	168.00	4,000.00	(3,832.00)
Stock—General Motors	1/ 7/37	1,634.91	3,165.00	(1,530.09)
Stock—Caterpillar Tractor	12/10/30	9,464.31	3,280.50	6,183.81
Bonds—Quarterly Income Shares.....	10/16/37	404.82	470.00	(65.18)
Bonds—Sourthern Pacific R. R.....	12/ 2/36	5,070.69	7,594.00	(2,523.31)

Net Loss.....

(20,652.79)
6,183.81*

26,836.60*

*Figures written in with pencil.

CHINOOK INVESTMENT CO.
INCOME FROM DIVIDENDS

Schedule F

Meier & Frank, Portland.....	\$ 18.00
Standard Oil Co. of Cal., San Francisco.....	200.00
Texas Gulf Sulphur, New York.....	1,100.00
Magma Copper, New York	275.00
New England Fish Co., Boston.....	246.00
Maryland Fund, New Jersey.....	602.17
Anaconda Copper, New York.....	175.00
N. W. Electric Co., Portland.....	5,698.00
American Snuff, Memphis.....	975.00
Pickle Crow Mining Co., Montreal.....	18.85
Briggs Mfg. Co., Detroit.....	125.00
Kennecott Copper, New York.....	645.83
Texas Corp., New York.....	225.50
Oregon Port. Cement, Portland.....	500.00
Incorporated Investors, Boston.....	822.00
Pullman Co., Wilmington, Del.....	300.00
Iron Fireman, Portland	1,962.00
Crown Zellerbach, San Francisco	648.67
Petrol. Corp. of Amer., New York.....	381.00
Peoples Water & Power, New York.....	300.00
Equity Corp., Jersey City.....	109.00
Crown Will. Paper Co., San Francisco.....	196.00
Caterpillar Tractor, San Francisco.....	5,260.00
Oregon Worsted, Portland	60.00
Transamerica, San Francisco	455.00
Quarterly Income, Jersey City.....	1,175.00
Supervised Shares, Jersey City.....	261.00
Pacific Lighting Co., Los Angeles.....	300.00
Cent. & S. W. Utilities, Chicago	910.00
Bankers Trustee, New York	18.68
Sperry Corp., New York.....	360.00
Bank of America, San Francisco.....	66.00
Pacific Internal Assn., Portland.....	550.00
North Amer. Aviation, New York.....	37.50
Richfield Oil Co., Los Angeles.....	25.00
General Motors, Detroit.....	187.50
Total.....	\$25,188.70

[Endorsed]: Filed Dec. 7, 1942.

Plaintiff's Pre-Trial Exhibit 6: Certified copy of Return on Personal Holding Company form for year 1937, of Chinook Investment Company;

PLAINTIFF'S PRE-TRIAL AND TRIAL EXHIBIT No. 6

Return of Personal Holding Company for Calendar Year 1937, Chinook Investment Company.
Page 1 of return

ADJUSTED NET INCOME COMPUTATION UNDER TITLE 1 A

Item	
1. Net income	\$19,918.77
4. Total of Items 1 to 3.....	19,918.77
6. Less: Federal income, war profits and excess- profits taxes	4,072.00
<hr/>	
10. Adjusted Net Income	15,846.77
12. Less: Dividends paid credit \$10,000.00	
14. Total of Items 12 and 13.....	10,000.00
15. Undistributed adjusted net income.....	5,846.77

COMPUTATION OF TAX

16. Surtax on portion of Item 15 not in excess of \$2,000 at 65%.....	1,300.00
17. Surtax on amount of Item 15 in excess of \$2,000 at 75%	2,885.08
<hr/>	
18. Total surtax in Items 16 and 17.....	4,185.08

Furnish below the names and addresses of the individuals who owned directly or indirectly at any time during the last half of the taxable year more than fifty per cent in value of the outstanding capital stock of the corporation:

Name	Address	Highest Percentage Owned During Last Half of Year
1. Robert S. Farrell, Sr.	Portland, Ore.....	43%
2. Nancy Jane & Robert S. Farrell, Jr.	Portland, Ore.....	23.8%
3. Marion L. Kingery	Portland, Ore.....	24%
4. Other members of family	Portland, Ore.....	9.2%

AFFIDAVIT OF ROBERT S. FARRELL

Portland, Oregon

November 14, 1939

Collector of Internal Revenue
Portland, Oregon

Delinquency in filing the Federal corporation income tax return for the period ending December 31, 1937, was due to the following reasons:

A return on Form 1120 was prepared and filed and failure to file the Form 1120P for Personal Holding Companies was due to the fact that it was the contention of the taxpayer that it was not a Holding Company and hence not required to file Form 1120P. The returns of the taxpayer had been examined for the year 1936 and the company declared not to be a Personal Holding Company, and the officers believed that the status of the Company had not changed as to the year 1937. The return herewith submitted is submitted at the request of the Internal Revenue Agent and the signing and submission thereof is made with the specific reservation that it is not an admission of affiant's liability as a Personal Holding Corporation, but is made

for the purpose of avoiding litigation if possible, and in the hope that an equitable determination of the taxpayer's status may be made without the necessity of legal action. The right to later contest the validity of the assessment as a Personal Holding Company is specifically reserved.

CHINOOK INVESTMENT
COMPANY

By ROBT. S. FARRELL
President

Subscribed and sworn to before me this 15 day
of November, 1939.

ROSALIE NOVAK

Notary Public for Oregon

My Commission Expires: 10/21/42.

[Endorsed]: Filed April 24, 1942.

Plaintiff's Pre-Trial Exhibit 7: Certified
copy of Internal Revenue Agent's Report dated
April 20, 1939;

Plaintiff's Pre-Trial Exhibit 8: Certified
copy of Waiver of Restrictions on Assessment
and Collection of Deficiency in Tax for 1937;

Plaintiff's Pre-Trial Exhibit 9: Certified
copy of Claim for Refund of \$363.62, received
by Collector [4] February 27, 1939;

Plaintiff's Pre-Trial Exhibit 10: Certified
copy of letter dated March 16, 1940, to Chinook

Investment Company, Portland, Oregon, from Guy T. Helvering, Commissioner;

Plaintiff's Pre-Trial Exhibit 11: Certified copy of Amended Claim for Refund of \$363.62 with interest, received by the Collector June 30, 1939;

Plaintiff's Pre-Trial Exhibit 12: Certified copy of Amended Claim for Refund of \$5,271.68, etc., together with copy of letter dated April 1st, 1941, to Chinook Investment Company, from Guy T. Helvering, Commissioner;

PRE-TRIAL AND TRIAL EXHIBIT No. 12

AMENDED CLAIM FOR REFUND

I.

Claimant's income in 1937 for normal tax purposes was as follows:

	Per Return	As Adjusted
Interest	180.00	180.00
Rents	18,418.91	18,418.91
Dividends	25,188.70	25,361.19
Total	43,787.61	43,960.10
Sale of bonds		
Loss (\$20,652.79) Allowed.....	(2,000.00)	(2,000.00)
	41,787.61	41,960.10
Deductions	26,674.11	22,041.33
Net Income	15,113.50	19,918.77
Dividends Received Credit.....	21,410.40	21,557.01
Balance subject to normal tax....	None	None

The excess-profits tax was computed as follows:

	Per Return	As Adjusted
Value of Capital Stock.....	122,541.85	122,541.85
Net Income for excess-profits.....	15,113.50	19,918.77
Less Dividends received credit....	21,410.40	21,557.01
<hr/>		
Balance of Net Income.....	None	None
Less 10 percent of Capital Stock value	12,254.19	12,254.19
Balance subject to excess-profits tax	None	None

It will be observed that no normal or excess profits tax was assessed. There is one objection, nevertheless, to the Commissioner's adjustments, as above set out, which is important with reference to other taxes assessed. That is to the disallowance of a deduction as an expense of \$4,632.78 paid as State and County taxes on property purchased on February 6, 1937. At the time of the purchase, none of the taxes for the previous year were due or payable, the assessment roll not having been delivered to the collector. Under the provisions of section 69-710, Oregon Code Annotated, 1935, the taxes were the obligation of the grantee. This section reads as follows:

“Grantor and Grantee—liability for taxes—
As between the grantor and the grantee of any real estate or real property, when there is no express agreement as to payment of the taxes thereof becoming due and payable in the calendar year of the sale, the grantor shall be liable in the same proportion of such taxes as the part of the year prior to the day of the sale

of such property bears to the whole of such year, and the grantee shall be liable for the remainder of such taxes.”

It is clear, therefore, that the taxes for the portion of the year subsequent to February 6, 1937, became the liability of the purchaser when the assessment rolls were delivered to the collector, and was properly deductible, therefore, as an expense incurred after acquisition of the property and was not part of the capital investment as contended by the Commissioner. It will be noted that the claimant was on the cash basis and that the statute quoted was adopted in 1935. The case of *Crown Willamette Paper Co.*, 14 BTA 133 (1928) on which the Commissioner relies, therefore, is not applicable.

II.

As to the determination that the Chinook Investment Company is a Personal Holding Company, insofar as the stock ownership is concerned, the company comes within the provision of the statute, but the requirements as to stock ownership and as to income are conjunctively stated in the act and the two conditions must concur in order to bring the corporation within the provisions of the statute.

It is the contention of this taxpayer that the amount of income from interest and dividends is not sufficient to subject the corporation to the provisions of the statute defining Personal Holding Company income. The question as to whether the income is such as to subject the Chinook Invest-

ment Company to the provisions of the act relating to Personal Holding Companies hinges upon the relation of the rent collected to the gross income of the corporation. We find by reference to section 352 of the Revenue Act of 1937, the following provisions:

“Sec. 352. Definition of Personal Holding Company.

“(a) General Rule.—For the purposes of this title and of Title I the term ‘personal holding company’ means any corporation if—

“(1) Gross Income Requirement.—At least 80 per centum of its gross income for the taxable year is personal holding company income as defined in section 353; - - -”

“Sec. 353. Personal Holding Company Income.

“For the purposes of this title the term ‘personal holding company income’ means the portion of the gross income which consists of:

“(a) Dividends, interest, royalties (other than mineral, oil, or gas royalties), annuities.”

“(g) Rents.—Rents, unless constituting 50 per centum or more of the gross income.”

From the above it will be noted that at least 80% of the gross income of a corporation must be “personal holding company income” in order to subject a corporation to tax. It is further to be noted that rents are to be included in such income unless they constitute 50% or more of the gross income of the corporation. By reference to the return of the Chi-

nook Investment Company, it will be noted that the items of income are as follows:

Interest on bank deposits, notes, etc.....	180.00
Rents	18,418.91
Loss from sale of stocks, bonds, etc.....	(20,652.79)
Dividends from corporations.....	25,188.70
<hr/>	
Gross Income	23,134.82

It is obvious from this computation that the rents exceed 50% of the total gross income by a wide margin, and hence for this reason, should not be included in the "personal holding company income".

The point of difference as to whether the rents exceed or do not exceed 50% of the gross income lies in the question as to whether in determining the total gross income, the corporation is limited to the loss of \$2,000, or whether they takes into account the losses actually sustained through the sale of stocks and bonds of \$20,652.79. In the determination of gross income, if any portion of the amount as reflected on the return is to be taken into account, the entire amount should be taken into consideration in determining the company's gross income. The sales of stocks and bonds during the year amounted to a sum in excess of \$100,000, and it goes without saying that "gross income" is represented by some measure of the price received for the goods. "Gross income" is generally conceded to mean the sale price of the article sold less the cost or other basis. Applying this accepted conception of "gross income" to the present situation, it is clear that the

full loss from the sale of the securities should be taken into account in determining gross income, and that the result of so doing is to make the "personal holding income" less than 80% of the total, and the ultimate result of this is to take this company out of the personal holding company classification, and, therefore, \$4,185.08 of the tax claimed herein was improperly assessed.

III.

A tax of \$1,086.60 was assessed on undistributed profits, based upon net income for surtax computation of \$19,918.77 (instead of \$15,285.99, which, in Section I, we showed was proper) less a dividends paid credit of \$10,000.00.

It will be noted in the tabulation under Section I, that taking into consideration the entire loss on the sale of bonds, \$20,652.79, there was an actual loss on claimant's year's operations in the amount of \$3,560.61, based on claimant's return. In assessing a tax on undistributed profits, this loss has been treated as earnings and profits in the sum of \$9,918.77.

This tax was improperly and illegally imposed for the following reasons:

1. Section 14 of the Revenue Act of 1936, purporting to impose a tax on undistributive profits, cannot apply when there are no profits;

2. If the tax is imposed on net income measured by the gains and profits not distributed, there is no measure for a tax when in fact there are no gains and profits;

3. Section 14 of the Revenue Act of 1936 should be construed with Section 23 as a part of the same Act, to determine the intent of Congress;

4. The effect of the imposition of a tax, in the instant case, is to make the incidence of the tax depend upon the distribution or failure to distribute a previously acquired surplus, which was not income to the claimant in the taxable year, to which the tax is restricted by Section 14(b);

5. The imposition of a tax in the instant case is a violation of the spirit and purpose of the Act.

6. The Capital losses incurred by the claimant corporation are deductible in full as having been incurred in the normal course of business by a regular dealer in stock and securities. The Chinook Investment Company is empowered by its charter to buy and sell stocks and bonds and transact business usually transacted by a credit and finance company; the corporation maintains regular offices and has employees who devote substantial portions of their time to the corporate business of the buying and selling and the operation investments; numerous purchases and sales of securities are made by the corporation in the regular course of business and all purchases are made for the purpose of resale at a profit.

7. The provisions of Section 14, 21, 22 and 23 of the Revenue Act of 1936, as applied to claimant, violate Article 9 and the 16th Amendment to the Constitution of the United States in that they impose a tax not on the receipt of net income but on its

non-disposition, thus constituting a direct tax, without apportionment on the unspent portion of corporate money.

8. The provisions of Sections 14, 21, 22 and 23 of the Revenue Act of 1936 violate the Tenth Amendment to the Constitution of the United States in that they attempt to regulate the internal affairs of corporations and constitute the exercise of powers not delegated to Congress.

9. The provisions of Section 14, 21, 22 and 23 of the Revenue Act of 1936 violate the Fifth Amendment to the Constitution of the United States in that they are arbitrarily retroactive in imposing a tax, in the instant case, on a surplus previously acquired.

Wherefore, the Claimant prays that this claim be allowed.

[Endorsed]: Filed April 24, 1942.

Plaintiff's Pre-Trial Exhibit 13: Certified copy of Articles of Incorporation of Chinook Investment Company;

PRE-TRIAL AND TRIAL EXHIBIT No. 13

* * * Chinook Investment Company—the duration perpetual; the enterprise, business, pursuit or occupation:

1. To own, buy, sell, or to acquire by sale, trade or exchange, bonds, notes, mortgages and other evi-

dences of indebtedness or shares of stock in other corporations, and to exercise while the owner thereof all the rights, powers and privileges, including the right to vote thereon, that a natural person being owner thereof might, could or would exercise, negotiate loans and transact any other business usually transacted by a credit or finance company.

[Endorsed]: Filed April 24, 1942.

Plaintiff's Pre-Trial Exhibit 14: Bundle of invoices of purchases and sales of stock by plaintiff;

Plaintiff's Pre-Trial Exhibit 14-a: Bundle of invoices of purchases and sales for year 1936 (previously part of Plaintiff's Pre-Trial Exhibit 14); and

Plaintiff's Pre-Trial Exhibit 14-b: Bundle of invoices of purchases and sales for the year 1937 (previously part of Plaintiff's Pre-Trial Exhibit 14); [5]

Defendant's Pre-Trial Exhibit 15: Certified copy of letter dated November 28, 1939, to Chinook Investment Company from J. W. Maloney, Collector, Portland, Oregon, in re deficiency in income tax for 1937 amounting to \$722.98; and

Defendant's Pre-Trial Exhibit 16: Certified copy of letter dated November 28, 1939, to Chinook Investment Company from J. W. Ma-

loney, Collector, in re deficiency in income tax for 1937 amounting to \$4,185.08.

Mr. Bischoff: Now at this time I will also offer in evidence the Pre-Trial transcript, after it is transcribed by the reporter. He hasn't been able to transcribe it.

The Court: It may be admitted.

(The transcript of Pre-Trial Proceedings so offered and received was later produced and marked Plaintiff's Exhibit 17.)

PLAINTIFF'S EXHIBIT No. 17

"Mr. Winter: If the Court please, in order that the Court might understand it, counsel has used the word "losses" in a general term. We are not concerned with losses in the operation, I mean operation losses or losses in the business; we are talking about a capital loss. The situation is briefly this: The taxpayer in this case had gross income which, without question, would put it in the classification of a personal holding company; that is its 80 per cent, or 70 per cent, whichever percentage is applicable to the situation here in question; that is, more than 80 per cent, for example; that is income lost from interest and the other items specified in the statute, which, of course, your Honor recalls in the previous personal holding income case which we tried here some time ago."

"Mr. Bischoff: Your Honor, perhaps I should have made my statement as to the law is-

sue as full as Mr. Winter did. It didn't occur to me this was the proper time, but may I be permitted to supplement what I said in that connection, to this extent? I don't intend to argue the point but to make the issue clear.

"It is our view that losses sustained in the sale of stocks under the circumstances in this case do not constitute capital losses within the meaning of the statute. Our position is that such losses from the sale of capital stock may or may not be loss on capital assets, depending upon the circumstances in each given case. That has to be determined as a fact in each case. Our view is that under the circumstances of the taxpayer's business, that the stock does not constitute capital asset, and, therefore, they would be entitled to take all of the loss sustained, instead of being limited to a two thousand dollar loss if it were capital asset. That is the first legal contention."

"Mr. Winter: Yes. We think it is purely a question of law in this case.

"Mr. Bischoff: Of course we don't agree with you that they are capital losses. All I was trying to ascertain is as to the figures."

[Endorsed]: Filed Feb. 24, 1942.

ROBERT S. FARRELL

was thereupon produced as a witness in behalf of the plaintiff and, having been first duly sworn, testified as follows:

Direct Examination

The Clerk: May I have your correct name for the reporter, please.

The Witness: Robert S. Farrell.

By Mr. Bischoff:

Q. Mr. Farrell, are you an officer of the Chinook Investment Company? A. I am.

Q. What office do you hold?

A. President. [6]

Q. And are you a stockholder of the Chinook Investment Company? A. I am.

Q. How long were you president of the Chinook Investment Company?

A. Thirty-one years.

Q. When was the Chinook Investment Company organized? A. 1911.

Q. And you became an officer, president, then?

A. I did.

Q. And have been president of the company ever since? A. I have; yes, sir.

Q. Who are the present stockholders and how much stock does each stockholder own at the present time? If you would like to refresh your recollection from the minute book you may do so.

Mr. Winter: Mr. Bischoff, we stipulated that with respect to 1937 the only issue involved in the

(Testimony of Robert S. Farrell.)

personal holding company income, it met the requirements fixed by the statute. I don't see the materiality of all this. Let's get down to facts which are material. What difference does it make who owns it now?

Mr. Bischoff: I think while we agree that, so far as stock ownership, it comes within the definition of the holding company statute, I think it is relevant for the Court to know, in considering the character of its business, which will be in issue as to how the stock is held.

Mr. Winter: Mr. Bischoff, you are not contending that— [7] your return for your personal holding company filed for the year 1937 shows the stock ownership. Are you contending anything different than that? The Court can get it from that.

Mr. Bischoff: I don't recall that it did set forth the names of the stockholders.

Mr. Winter: Oh, yes; the names of the stockholders and the per cent they own.

Mr. Bischoff: At any rate, we would like to make our case and show the facts we think are relevant, your Honor, upon the other issues.

Mr. Winter: We object to it on the ground it is immaterial what is the ownership now, and that is the question.

The Court: He may answer, subject to the objection.

Mr. Bischoff: You may answer, Mr. Farrell.

(Testimony of Robert S. Farrell.)

A. R. S. Farrell, Sr.—that is I—215 shares; my son, Junior, 119 shares; Marion Kingery 120 shares; Susan M. Farrell 6 shares; Frederick Kingery 10 shares; Susan Kingery 10 shares; Joan Farrell 10 shares; Sally Farrell 10 shares.

Q. Now has the stock ownership been substantially the same for some years past, or have there been any changes?

A. It has for many years, yes.

Q. Mr. Farrell, what is the business of the Chinook Investment Company?

A. It is a company we organized to buy and sell real estate, stocks, bonds, automobiles, merchandise of any kind—buy and [8] sell, of course, for a profit. We didn't organize to sell for a loss, but we have sold for a loss.

Q. And has it been engaged in that business from the time of its organization? A. It has.

Q. Is there anything in the way of a division of responsibilities or duties in the corporation? What part of the business have you looked after principally?

A. I, as president of the corporation, look after the buying and the selling of practically all the merchandise, all of the stocks and bonds and real estate, and I have the authority to sign checks and make loans. The minutes of the company give me that authority.

Mr. Winter: Now wait. We object to it and ask that it be stricken as hearsay, not the best evi-

(Testimony of Robert S. Farrell.)

dence. He says that is what the books authorize. The books are the best evidence of what they authorize.

The Court: The answer may stand, subject to the objection.

Mr. Bischoff: Q. What part of the business does your son conduct?

A. My son is the manager of the company and looks after the real estate, the renting and securing of tenants, and making repairs and various other items connected with the real estate, in which I take no personal interest.

Q. Has this division of responsibilities as you have practiced [9] them been the same for some years past?

A. For many years back.

The Court: The name Susan Kingery, that is your married daughter, is it?

A. Yes. That is my daughter's daughter, Susan Kingery. Marion Kingery is my daughter.

The Court: You have just the two children, just the daughter and the son?

A. That is all.

Mr. Bischoff: Q. Mr. Farrell, in the purchase and sale of securities, did you limit that in any way to securities that are spoken of as listed securities; that is, those that are sold on exchanges; or did you buy and sell over the counter and from hand to hand, from parties?

Mr. Winter: Oh, if the Court please, I think the question is entirely leading. Why doesn't he ask

(Testimony of Robert S. Farrell.)

him for the facts, not suggest answers? I object to it on the ground it is leading.

The Court: Go ahead and give the facts, Mr. Farrell. You know what we want to get at, the facts of the case.

A. We bought and sold them over the counter, and also at random, and also listed securities, and anywhere.

Mr. Bischoff: Q. Do you maintain an office for the transaction of the business of the company, for the sale and purchase of securities? [10]

A. We do. We have an office at 536 Southwest First Avenue.

Q. And did you maintain that office in 1936 and 1937?

A. No. We had to move there this last year; a year ago we were at the same number Southwest Front Street and the Front Street improvement took it over.

Q. Did you maintain an office for the transaction of that business in 1936 and 1937?

A. We did.

Q. Where was that office maintained?

A. 536 Southwest Front Avenue.

Q. In the years 1936 and 1937, and for several years preceding that, how extensive was the business of the corporation in the purchase and sale of securities?

A. We bought and sold, I would, just guessing at it, say from two hundred to three hundred thou-

(Testimony of Robert S. Farrell.)

sand dollars a year; generally bought and sold about the same amount, because we never carried much cash on hand.

Q. I don't quite understand the answer. Do you mean that the sales would amount from two to three hundred thousand a year? A. Yes.

Q. And the purchases would amount to approximately the same?

A. About the same, because we kept the cash moving all the time.

Q. Will you explain the process or the procedure that you employed generally during those years that I have spoken of, as to the manner in which you bought securities? [11]

A. I keep in very close touch with the market; in fact, I belong to Babson & Company, and take the Financial World, and other financial papers, and watch the stock market every day in the paper, except Monday, because there is no market on Sunday, and when I find something that looks reasonably well to buy, or if I have something that looks well to sell, I do buy or sell as I see fit.

Q. That has to do with the listed securities?

A. With the listed securities, yes.

Q. Now what is your practice with respect to the securities that you buy privately? You state generally how that business was carried on.

A. I have a number of unlisted securities, such as the Oregon Pulp & Paper Company, St. Helens Pulp & Paper Company, some of these local com-

(Testimony of Robert S. Farrell.)

panies, and if I feel that the market justifies my buying I buy them; if I feel it justifies selling I sell them. To do so I go to the broker or to an outsider, often to an outsider, and ask him if they wish to buy or if they have any to sell, if I know they have any, which I do. I know the stockholders of these companies very well, because I attend the annual meetings; I have one this afternoon of the St. Helens Pulp & Paper Company; and I know most of the stockholders and we confer with each other on prices, and if I want to buy any more, which I may do this afternoon, or if I want to sell any I may sell. [12]

Q. You mean by that you make purchases direct from other owners of stock?

A. Direct from other owners. I have bought numbers of times from the owners.

Q. Now was that practice followed in 1936 and in 1937? A. It was.

Q. And was that practice generally followed in the preceding years? A. It was.

Q. Are you solicited at your office by people who have securities for sale, or who want to buy securities?

A. Yes. We are solicited, I would safely say, at least every day five brokers, and sometimes as many as ten, come to my office or phone and ask if I want to buy or sell.

Q. Now in these negotiations or dealings with brokers, are those for the purpose of selling or buy-

(Testimony of Robert S. Farrell.)

ing for your account, or are those transactions involving direct sales by you to them, or direct purchases by you from them?

A. Either direct purchases, one way or the other. I never buy or sell on margin, if that is what you are asking about.

Mr. Winter: I ask that that question be stricken as not responsive. He asked him if he purchased stock for others, or just for his own corporation—purchased and sold for others.

Mr. Bischoff: No, that wasn't the question. [13]

Mr. Winter: Well, if that wasn't the question, then we will object to any further testimony on this line, unless you are contending that they come within—that this corporation comes within the exception of the buying and selling of stock under the exemption in the statute. Do you claim it comes within the exception?

Mr. Bischoff: May it please the Court, the question I asked was designed to bring out whether, in these negotiations with brokers whether they were negotiating a sale or purchase by the broker, or the Chinook Investment Company's account as broker, or whether it was a case of a direct purchase from the broker, or a sale to the broker, as distinguished from an agency transaction. That was what my question was.

Mr. Winter: You don't contend there regular dealers in stock come within the exemption, do you?

Mr. Bischoff: I maintain that the business of

(Testimony of Robert S. Farrell.)

this corporation was in part the purchase and sale of securities as a regular business.

Mr. Winter: Oh.

The Court: What you call trading business?

Mr. Bischoff: I beg pardon?

The Court: Would you call it a trading business, trading company?

Mr. Bischoff: I don't know whether your Honor uses the term "trading" in the restricted sense. It was a regular part of [14] their business to buy and sell merchandise, the same as a merchant buys and sells merchandise.

Mr. Winter: Not to buy for someone else?

Mr. Bischoff: No.

Mr. Winter: Or to sell for someone else, except their own stock?

Mr. Bischoff: We don't claim that the Chinook Investment Company was a brokerage house buying or selling for anybody else. We don't claim that.

Mr. Winter: My question, if the Court please—my objection, if the Court please, was, if that was their business, which I take it now they don't claim, that it is a regular dealer in stocks within the exception in the statute, to object on the ground that was not one of the grounds alleged in the claim for refund. They never claimed that, have not tried to show that in any respect, and it is not pleaded in the case. But since they are saying they are not trying to show it comes within that exception, then it is irrelevant and immaterial.

(Testimony of Robert S. Farrell.)

The Court: There is a definite type in the investment world, many of whom I have known personally, who buy and sell constantly.

Mr. Winter: For their own investment, yes.

The Court: Their own investments, and while this is a corporation, I take it that is the type of business you are seeking to establish here. [15]

Mr. Bischoff: Yes. It bought for its own account and sold for its own account.

The Court: A man could go down to any financial district anywhere and find in most any financial office people who make their living that way. Having accumulated a certain amount of money and invested it, they are moving their investment in and out all the time; and I take it that is what you claim was Mr. Farrell's business?

Mr. Bischoff: We claim it, not as investments but as business.

Mr. Winter: They are still capital assets, if they own them. They can't be anything else.

Mr. Bischoff: I am not arguing that as a legal matter. I am trying to explain what the facts are and the Court will draw his conclusion from them. I am trying to distinguish the type of business the corporation engaged in from the trader that buys on margin, a few points margin from day to day and turns over a day's point or two. I was trying to get the exact picture as it is, so in the end your Honor will draw your own legal conclusion as to what kind of a corporation this is.

(Testimony of Robert S. Farrell.)

The Court: Oh, I think I understand from what Mr. Farrell has said. He said something about two to three hundred thousand dollars. We will take the latter figure. If he had \$300,000 employed in this business he kept it moving.

Mr. Bischoff: Yes. [16]

The Court: And he sought to make money as a trader for his own account, buying from the man who had to sell at a disadvantage, for reasons of his own, and selling, and the man who wasn't as good a buyer as Mr. Farrell was the seller.

Mr. Bischoff: That is substantially it.

The Court: That is a common type in the investment world.

Mr. Bischoff: Now Mr. Farrell, did you buy and sell on margin?

A. I never did.

Q. All your purchases are for cash, and you sell for cash?

A. Always. I should say "we" instead of "I". I or we either, never have.

Q. It is the corporation I am talking about.

A. In other words, we are not gamblers.

Q. Now did you buy the securities for the purpose of salting them away and merely drawing dividends, or did you buy them with a view of selling them at a profit?

Mr. Winter: If the Court please, we will object to that as calling for a conclusion of the witness. I think he can state what he actually did, when he

(Testimony of Robert S. Farrell.)

bought them, what he bought, and when he sold. It would be a rank conclusion.

The Court: He may answer, subject to the objection.

Mr. Bischoff: You may answer.

A. We always bought and sold for a profit, tried to do so.

The Court: You never had anything you would not sell if you could make a profit on it? [17]

A. No. Of course we don't want to, but we did sell at a loss. We never salt it away, put it in a safe deposit box and say, "We will never look at it again", saying it is a good investment. That wasn't the idea of the company.

The Court: In fact, you figured on getting part of your living out of what you could make in your trading, didn't you?

A. That is what I make my living at.

Mr. Winter: The capital loss was \$28,000 in one year. He didn't make much of a living.

Mr. Bischoff: Q. Mr. Farrell, I will ask you to look at this bundle of invoices of purchases and sales, which have been marked Plaintiff's Exhibit 14, 14-a and 14-b, and I will ask you to state what they represent.

A. These are invoices of purchases and memorandas of sales made by the Chinook Investment Company for many years back.

Q. Now Mr. Farrell, I will ask you to look at the bundle which is marked Exhibit 14-a and state

(Testimony of Robert S. Farrell.)

if that is the group of transactions that were handled in 1936.

Mr. Winter: Those were all purchases, I think.

The Witness: This is marked 14.

Mr. Bischoff: Well, just take the rubber band off and take them apart. May I have permission to go up to the witness stand?

The Court: Yes.

Mr. Bischoff: Q. I show you this Exhibit 14-a and ask you [18] if these are invoices covering the transactions handled in 1936?

A. They are.

Q. And I will show you the bundle that has been marked Exhibit 14-b and ask you if those are invoices representing transactions in securities handled in 1937. A. They are.

Q. Now Mr. Farrell, are these all of the invoices covering all of the transactions, purchases and sales, that the Chinook Investment Company engaged in during that period of time?

A. They are not all. Previous to 1936 we had probably many more, and while our offices were at 536 Southwest Front Avenue, when we were compelled to move on account of the Front Street improvement I happened to be out of the city at the time and our boys that are in the store with us, they moved my stuff and evidently lost a lot of it because I couldn't find some, oh, in the '20's and looking for them the other day I found some things I had lost for the past year that I hadn't known

(Testimony of Robert S. Farrell.)

were there. They evidently took out from our store of Everding & Farrell two truckloads of old papers and books to the crematory and had them burned up because they thought they were of no value, and evidently took some of my papers previous to 1936, some of the sales tags and purchase papers.

Q. Are these all the invoices that you were able to locate?

A. These are all I have been able to locate at present. Possibly I could find more by looking through everything, but so far [19] that is all I could find.

Mr. Bischoff: Your Honor, these are exhibits among those which Mr. Winter has objected to, and I don't know whether it is necessary to re-offer them or whether your Honor will deal with them in conclusion.

The Court: I consider them admitted subject to the objection.

Mr. Bischoff: You may cross examine.

Cross Examination

By Mr. Winter:

Q. Mr. Farrell, when you testified as to the stock ownership, in your personal holding company return for personal holding company for 1937, you set forth 43 per cent of the stock, common stock, was owned by yourself, and 23.8 per cent was held by Nancy Jane and Robert S. Farrell, Jr., and 26 per cent by Marion L. Kingery—24 per cent—and

(Testimony of Robert S. Farrell.)

other members of the family 9.2 per cent, the total 100 per cent. Those were all members of your family, were they?

Mr. Bischoff: Just one moment, Mr. Farrell. I have no objection to the question as such, except the statement of counsel which is incorporated into the question that that is the corporation's personal holding company return. That is not the fact, and this was a return prepared by the revenue agent for execution by the taxpayer, and who refused to execute it as such because it didn't regard itself legally as a personal holding company.

[20]

Mr. Winter: I beg your pardon. You want to look at the return. It is subscribed and sworn to by your witness, and also endorsed by Mr. Jacob, of counsel here, signed by him. Evidently you haven't seen it. You offered it in evidence.

Mr. Bischoff: Your Honor, without conceding—we have no objection to the question as such, but we don't want to be understood as consenting that this represents a corporation personal holding company return. That is the legal implication in the question.

Mr. Winter: Q. Showing you, Mr. Farrell, what has been marked as Plaintiff's Exhibit 6, I will ask you whether or not that is your signature appearing thereon, on the front page there.

A. On the black one?

Q. Yes. Is that your signature?

(Testimony of Robert S. Farrell.)

A. That is my signature.

Q. Did you subscribe and swear to it before a notary public? A. Yes.

Q. And that is your return? A. Yes, sir.

Q. And when you report in there the percentages of stock owned by you and your family they were correct, were they?

A. I didn't figure them out now, but if I signed it it was correct.

Q. It was correct. Then all of the stock was owned by you and your family during practically all of the time of this corpora- [21] tion?

A. Well, indirectly, by indirect family some.

Q. Well, you are talking about sons-in-laws and daughters-in-law; is that correct? Is that what you mean by indirect?

A. Yes; and grandsons and grandchildren.

Q. Now Mr. Farrell, you testified that you were buying and selling securities for the corporation for a profit to the corporation, for an investment for the corporation; isn't that right?

A. For what?

Q. The corporation was investing in stocks, wasn't it? A. Yes.

Q. Yes. And you, as president and secretary, handled that end of the business?

A. Yes, sir.

Q. All right. Now I will show you what has been marked for identification, what has been introduced in evidence as Plaintiff's Pre-Trial Ex-

(Testimony of Robert S. Farrell.)

hibit 1, and ask you to turn to Schedule B, Capital Gains and Losses, and ask you to just state to the Court when you purchased those stocks shown therein and when you sold them, and the names of them. First, the name of the stock, Schedule B?

A. This list up here (indicating)?

Q. Yes. What is the first stock listed there?

A. Grandy Copper Company.

Q. And when did you acquire it?

A. 1930. [22]

Q. And when did you sell it? A. '36.

Q. You held that stock for six years?

A. Yes.

Q. All right. Now read the next one.

A. Texas Gulf Sulphur Company.

Q. All right. When did you acquire that?

A. 1929, I think it is.

Q. Yes. And you sold it? A. '36.

Q. Some seven years later, in '36?

A. Yes.

Q. All right. What was the next stock?

A. Guardian Investors, 1928, sold in '36.

Q. Yes. A. Shall I read on?

Q. Yes. Read the next one.

A. Portland Gas & Coke.

Q. When did you acquire it?

A. 1932, and sold in '36.

Q. Yes. Now the next one?

A. Northwest Electric.

Q. When did you acquire it? A. 1931.

(Testimony of Robert S. Farrell.)

Q. When did you sell it? [23]

A. Sold it in '36.

Q. The next one?

A. Interstate Securities—no; Interstate Equities.

Q. When did you acquire that?

A. It is such fine writing you can hardly see it. 1928.

Q. 1928. You didn't sell it until when?

A. '36.

Q. Then the next one?

A. Caterpillar Tractor, 1929, sold it in '36.

Q. That is seven years later, is that right, after you acquired it? A. Yes, sir.

Q. Then the next one.

A. Chile, bonds of the Government of Chile, 1929.

Q. When did you sell them?

A. Sold them in '36.

Q. In every stock there you have shown the profit and loss on the sale during that year you had acquired more than four years prior to the time you sold them, and you held them that long, didn't you? A. Yes, sir.

Q. That is right. And you subscribed and swore to that return, did you not? A. I did.

Q. And it is true? [24] A. It is.

Q. And you claimed a capital loss on the sale of some of those stocks, one of which showed a profit; is that right? A. Yes, sir.

Mr. Winter: I think that is all.

(Testimony of Robert S. Farrell.)

Redirect Examination

By Mr. Bischoff:

Q. Mr. Farrell, with respect to this former exhibit that was shown to you by Mr. Winter, Exhibit 6, was this letter of explanation for the execution of that personal holding company return attached to the return when you made it? Please hand this to the witness. Just read that letter and state if that letter of explanation wasn't attached to the return when you made it.

A. No, it was not. It was after.

Q. No. Just look at it again and see.

A. It says 1939 up here.

Q. Well, that may recall to you that this supplemental return was filed in 1939.

A. Oh.

Q. Just read the letter and see if that won't refresh your recollection as to the submission of that letter with the return.

A. I state here that at the time that we paid the tax we did not regard it——

Mr. Winter: I object to it as not responsive. He can answer [25] whether it was or not.

Mr. Bischoff: Let him get through with what he wants to say and then make a motion.

Mr. Winter: No. You asked him whether it was attached thereto or not, and it calls for a "yes" or "no" answer.

A. It was not attached to the original return.

Mr. Winter: Yes.

(Testimony of Robert S. Farrell.)

Mr. Bischoff: Q. But was it attached to this supplemental return that was filed?

Mr. Winter: I don't know of any supplemental return that was filed.

Mr. Bischoff: Well, this paper you just tendered him, to which that letter was attached. That is what I am referring to.

Mr. Winter: You are referring to your Exhibit 6.

Mr. Bischoff: Yes.

A. It evidently was attached to the supplementary return.

Q. That is what I wanted. May I have that exhibit, Mr. Bailiff, please.

The Witness: It says there, "The return herewith submitted", so it must have been attached to it.

Mr. Bischoff: May I call to your Honor's attention, in explanation of the objection that I made, this letter, which forms a part of the exhibit and is attached thereto, reads:

"Collector of Internal Revenue, Portland,
Oregon.

"Delinquency in filing the Federal Corporation Income [26] Tax Return for the period ending December 31, 1937, was due to the following reasons:

"A return on Form 1120 was prepared and filed and failure to file the Form 1120P for Personal Holding Companies was due to the

(Testimony of Robert S. Farrell.)

fact that it was the contention of the taxpayer that it was not a Holding Company and hence not required to file Form 1120P. The returns of the taxpayer had been examined for the year 1936 and the company declared not to be a Personal Holding Company, and the officers believed that the status of the Company had not changed as to the year 1937. The return herewith submitted is submitted at the request of the Internal Revenue Agent and the signing and submission thereof is made with the specific reservation that it is not an admission of affiant's liability as a Personal Holding Corporation, but is made for the purpose of avoiding litigation, if possible, and in the hope that an equitable determination of the taxpayer's status may be made without the necessity of legal action. The right to later contest the validity of the assessment as a personal holding company is specifically reserved.

“CHINOOK INVESTMENT
COMPANY,

By ROBERT S. FARRELL,
President.

“Subscribed and sworn to before me this 15
day of November, 1939.”

And that corresponds to the date of the execution of the supplemental return to which it is attached. That is all. [27]

(Testimony of Robert S. Farrell.)

Recross Examination

By Mr. Winter:

Q. But the information upon that return you swore to was the truth, the information according to your books as to the stock ownership?

A. It was the truth.

Q. Yes.

A. So far as I know now it was, I would say, the truth, because I swore to it.

Mr. Winter: That is all.

The Witness: I don't generally swear to anything that *it* not the truth.

Mr. Winter: That is all.

(Witness excused.)

Mr. Bischoff: That is the plaintiff's case, your Honor.

Mr. Winter: We rest.

The Court: How much time for briefs?

Mr. Bischoff: May we have fifteen days for the plaintiff's brief?

The Court: Your time, Mr. Winter?

Mr. Winter: May I have an equal amount, your Honor? I find it difficult to take less than that after receipt of brief, because I usually wait until I get the brief.

The Court: Five or ten days for reply, if deemed necessary? [28]

Mr. Bischoff: Yes, your Honor. That is all right.

Mr. Winter: May I inquire, will you prepare the pre-trial order?

Mr. Bischoff: I will prepare the pre-trial order and I will send it to you before it is submitted.

Mr. Winter: Yes.

The Court: Adjourn until tomorrow morning at ten o'clock.

(Thereupon at 2:54 o'clock P. M. the hearing was concluded.) [29]

[Title of District Court and Cause.]

CERTIFICATE OF COURT REPORTER

I, Alva W. Person, hereby certify that I reported in shorthand all of the oral proceedings had and evidence given upon the hearing of the above entitled cause on Tuesday, February 17, 1942, before the above entitled Court, Honorable Claude McColloch, Judge, presiding; that I subsequently reduced my shorthand notes to typewriting, and the foregoing and hereto attached 20 pages of typewritten matter, numbered 1 to 29, both inclusive, constitute a full, true and accurate record of said oral proceedings and evidence given upon said hearing so taken by me in shorthand as aforesaid, and of the whole thereof.

Dated at Portland, Oregon, this February 21st, 1942.

ALVA W. PERSON

Court Reporter. [30]

[Endorsed]: No. 10324. United States Circuit Court of Appeals for the Ninth Circuit. United States of America, Appellant, vs. Chinook Investment Company, a corporation, Appellee. Transcript of Record. Upon Appeal from the District Court of the United States for the District of Oregon.

Filed December 5, 1942.

PAUL P. O'BRIEN,

Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

In the United States Circuit Court
of Appeals for the Ninth Circuit

No. 10324

CHINOOK INVESTMENT COMPANY,
Appellee,

vs.

UNITED STATES OF AMERICA,
Appellant.

APPELLANT'S STATEMENT OF POINTS

Comes now the United States of America, appellant above named, and for its Statement of Points upon which it intends to rely in this appeal adopts the Statement of Points filed by it in the United States District Court in connection with its Notice of Appeal and included in the tran-

script of record prepared and certified by the Clerk of the said District Court, page 34 thereof.

CARL C. DONAUGH

United States Attorney

MASON DILLARD

Assistant United States
Attorney

THOMAS R. WINTER

Special Assistant to the Chief
Counsel, Bureau of Inter-
nal Revenue

Copy received this 5th day of October, 1942.

S. J. BISCHOFF

Of Counsel for Plaintiff

[Endorsed]: Filed Dec. 5, 1942.

